

Standard Chartered Bank
(Hong Kong) Limited

Directors' Report and
Consolidated Financial
Statements

For the year ended
31 December 2014

Standard Chartered Bank (Hong Kong) Limited
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Report of the directors

The directors have pleasure in submitting their annual report together with the audited financial statements for the year ended 31 December 2014.

Principal place of business

Standard Chartered Bank (Hong Kong) Limited (the “Bank”) is a bank incorporated and domiciled in Hong Kong and has its registered office at 32/F., 4 – 4A Des Voeux Road Central, Hong Kong.

Principal activities

The Bank is a licensed bank registered under the Hong Kong Banking Ordinance. The Bank’s principal activities are the provision of banking and related financial services. The principal activities and other particulars of the Bank’s principal subsidiaries are set out in note 19 to the financial statements.

Financial statements

The profit of the Bank and its subsidiaries for the year ended 31 December 2014 and the state of the Bank’s and its subsidiaries’ affairs as at that date are set out in the financial statements on pages 5 to 142.

During the year ended 31 December 2014, the directors had declared and paid an ordinary dividend of HK\$1.9215 (2013: HK\$1.60125) per each “A” and “B” ordinary share totalling HK\$3,722 million (2013: HK\$3,102 million).

Details of the movements in reserves are set out in the consolidated statement of changes in equity.

Charitable donations

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK\$11 million (2013: HK\$8 million).

Fixed assets

Details of the movements in fixed assets are set out in note 21 to the financial statements.

Share capital

Details of the movements in the share capital of the Bank during the year are set out in note 32 to the financial statements.

Directors

The directors during the year and up to the date of this report are:

Executive directors

Tan Siew Boi (re-designated as an executive director on 1 July 2014)

Ling Fou Tsong

Report of the directors (continued)

Non-executive directors

Hung Pi Cheng Benjamin (appointed as chairman on 28 May 2014 and re-designated as a non-executive director on 1 July 2014)

Tsang King Suen Katherine, Chairperson (resigned on 28 May 2014)

Jaspal Singh Bindra

Julian Fong Loong Choon

Sunil Kaushal (appointed on 5 March 2014)

Gavin Rodney Opperman (resigned on 1 July 2014)

Norman Lyle* (resigned on 1 April 2014)

Chan Wing Kin*

Fong Ching*

Stephen Robert Eno*

Cheng Edward Wai Sun* (appointed on 3 April 2014)

** Independent non-executive directors*

Fong Ching, Stephen Robert Eno, Gavin Rodney Opperman, Sunil Kaushal and Cheng Edward Wai Sun were re-elected at the 2014 annual general meeting in accordance with Article 109 of the Bank's Article of Association.

Directors' service contracts

The maximum term of appointment of independent non-executive directors is 2 years. Their remuneration is determined by the shareholders at the annual general meeting.

Directors' interests in Share Option Schemes

Certain directors of the Bank have been granted options under various share option schemes of Standard Chartered PLC, the ultimate holding company of the Bank. During the year, Jaspal Singh Bindra, Tsang King Suen Katherine, Hung Pi Cheng Benjamin, Julian Fong Loong Choon, Gavin Rodney Opperman, Ling Fou Tsong, Tan Siew Boi and Sunil Kaushal were granted options under these schemes.

Directors' rights to acquire shares

At no time during the year was the Bank, any of its holding companies, subsidiaries, or fellow subsidiaries, a party to any other arrangement to enable the directors of the Bank to acquire benefits by means of the acquisition of shares in or debentures of the Bank or any other body corporate.

Directors' interests in contracts

No contract of significance to which the Bank, its holding companies, subsidiaries or fellow subsidiaries was a party and in which a director of the Bank had a material interest, subsisted at the end of the year or at any time during the year.

Report of the directors (continued)

Auditor

The financial statements have been audited by KPMG who will retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as the auditor of the Bank is to be proposed at the forthcoming annual general meeting.

On behalf of the Board

Hung Pi Cheng Benjamin
Chairman

Hong Kong, 4 March 2015

Independent auditor's report to the shareholders of Standard Chartered Bank (Hong Kong) Limited

(Incorporated in Hong Kong SAR with limited liability)

We have audited the consolidated financial statements of Standard Chartered Bank (Hong Kong) Limited (the "Bank") and its subsidiaries (together "the Bank and its subsidiaries") set out on pages 5 to 142, which comprise the consolidated and the bank balance sheets as at 31 December 2014, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and the bank statements of changes in equity and the consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the financial statements

The directors of the Bank are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board and with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. This report is made solely to you, as a body, in accordance with section 80 of Schedule 11 to the new Hong Kong Companies Ordinance (Cap. 622), and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Bank and of the Bank and its subsidiaries as at 31 December 2014 and of the Bank and its subsidiaries' profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants

8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

4 March 2015

Consolidated income statement
For the year ended 31 December 2014
(Expressed in millions of Hong Kong dollars)

	Note	2014 HK\$'M	2013 HK\$'M
Interest income	4(a)	18,899	18,514
Interest expense	4(b)	(5,169)	(5,274)
Net interest income		<u>13,730</u>	<u>13,240</u>
Fee and commission income		10,434	8,112
Fee and commission expense		(520)	(634)
Net fee and commission income	4(c)	9,914	7,478
Net trading income	4(d)	1,023	3,529
Net gains from financial instruments designated at fair value through profit or loss	4(e)	641	124
Net gains from disposal of available-for-sale securities	5	19	17
Other operating income	4(f)	3,121	2,385
		<u>14,718</u>	<u>13,533</u>
Total operating income		28,448	26,773
Staff costs		(6,924)	(6,624)
Premises and equipment		(2,763)	(2,420)
Others		(5,156)	(4,539)
Operating expenses	4(g)	(14,843)	(13,583)
Operating profit before impairment		13,605	13,190
Impairment charges on advances to banks and customers	6(a)	(2,141)	(1,019)
Other impairment charges	6(b)	(911)	(3)
Operating profit after impairment		10,553	12,168
Share of profit of associates		1,412	1,188
Profit before taxation		11,965	13,356
Taxation	7(a)	(1,560)	(1,981)
Profit after taxation		<u>10,405</u>	<u>11,375</u>
Attributable to:			
Equity shareholders of the Bank		10,405	11,368
Non-controlling interests		-	7
Profit after taxation		<u>10,405</u>	<u>11,375</u>

The notes on pages 13 to 142 form part of these financial statements.

Consolidated statement of comprehensive income**For the year ended 31 December 2014***(Expressed in millions of Hong Kong dollars)*

	2014 HK\$'M	2013 HK\$'M
Profit after taxation	10,405	11,375
Other comprehensive income:		
<u>Items that will not be reclassified to the income statement:</u>		
Defined benefit plans:		
– Remeasurement of net defined benefit liability	9	267
– Related tax effect	(2)	(44)
<u>Items that may be reclassified subsequently to the income statement:</u>		
Available-for-sale securities:		
– Changes in fair value recognised during the year	237	(315)
– Changes in fair value transferred to the income statement on disposal	(19)	(17)
– Transfer to the income statement on fair value hedged items attributable to hedged risk	54	266
– Related tax effect	(13)	16
Cash flow hedges:		
– Changes in fair value recognised during the year	102	(105)
– Transfer to the income statement on termination of hedging derivatives	(1)	(11)
– Related tax effect	(17)	19
Exchange difference	(63)	62
	<hr/>	<hr/>
Other comprehensive income for the year, net of tax	287	138
	<hr/>	<hr/>
Total comprehensive income for the year	10,692	11,513
	<hr/> <hr/>	<hr/> <hr/>
Attributable to:		
Shareholders of the Bank	10,692	11,506
Non-controlling interests	–	7
	<hr/>	<hr/>
	10,692	11,513
	<hr/> <hr/>	<hr/> <hr/>

The notes on pages 13 to 142 form part of these financial statements.

Consolidated balance sheet as at 31 December 2014*(Expressed in millions of Hong Kong dollars)*

	Note	2014 HK\$'M	2013 HK\$'M
Assets			
Cash and balances with banks, central banks and other financial institutions	10	53,076	26,885
Placements with banks and other financial institutions	11(a)	145,770	125,868
Hong Kong SAR Government certificates of indebtedness	12	36,741	34,581
Trading assets	13	23,388	38,861
Financial assets designated at fair value	14	1,575	2,154
Investment securities	17	172,302	199,181
Advances to customers	15(a)	454,996	453,558
Amounts due from immediate holding company	18	70,263	53,689
Amounts due from fellow subsidiaries	18	46,061	35,180
Interest in associates	20	9,008	8,331
Fixed assets	21	39,950	28,573
Goodwill and intangible assets	22	1,116	1,933
Current tax assets		266	7
Deferred tax assets	27	141	275
Other assets	23	24,389	15,156
		<u>1,079,042</u>	<u>1,024,232</u>
Liabilities			
Hong Kong SAR currency notes in circulation	12	36,741	34,581
Deposits and balances of banks and other financial institutions		32,605	16,213
Deposits from customers	24	851,029	817,428
Trading liabilities	28	12,800	23,547
Financial liabilities designated at fair value	26	14,915	5,723
Debt securities in issue	25	13,838	15,336
Amounts due to immediate holding company	18	17,209	19,013
Amounts due to fellow subsidiaries	18	3,644	3,852
Current tax liabilities		18	786
Deferred tax liabilities	27	212	112
Other liabilities	29	19,582	22,047
Subordinated liabilities	31	10,406	10,548
		<u>1,012,999</u>	<u>969,186</u>
Equity			
Share capital	32	20,256	97
Reserves	33	45,787	54,949
Shareholders' equity		<u>66,043</u>	<u>55,046</u>
		<u>1,079,042</u>	<u>1,024,232</u>

Approved and authorised for issue by the Board of Directors on 4 March 2015.

Hung Pi Cheng Benjamin
Chairman

Tan Siew Boi
Director

Ling Fou Tsong
Director

Wang Wei Min
Company Secretary

The notes on pages 13 to 142 form part of these financial statements.

Balance sheet as at 31 December 2014*(Expressed in millions of Hong Kong dollars)*

	Note	2014 HK\$'M	2013 HK\$'M
Assets			
Cash and balances with banks, central banks and other financial institutions	10	53,064	26,697
Placements with banks and other financial institutions	11(a)	145,757	125,857
Hong Kong SAR Government certificates of indebtedness	12	36,741	34,581
Trading assets	13	23,388	38,861
Financial assets designated at fair value	14	1,575	2,154
Investment securities	17	172,302	199,181
Advances to customers	15(a)	452,717	440,186
Amounts due from immediate holding company	18	68,680	52,495
Amounts due from fellow subsidiaries	18	45,785	34,906
Amounts due from subsidiaries of the Bank	18	49,900	37,407
Investments in subsidiaries of the Bank	19	853	1,222
Interest in associates	20	3,729	4,127
Fixed assets	21	3,163	2,903
Goodwill and intangible assets	22	1,116	1,130
Current tax assets		256	–
Deferred tax assets	27	122	227
Other assets	23	9,365	13,155
		<u>1,068,513</u>	<u>1,015,089</u>
Liabilities			
Hong Kong SAR currency notes in circulation	12	36,741	34,581
Deposits and balances of banks and other financial institutions		32,605	15,008
Deposits from customers	24	851,029	816,300
Trading liabilities	28	12,800	23,547
Financial liabilities designated at fair value	26	14,915	5,723
Debt securities in issue	25	13,838	15,336
Amounts due to immediate holding company	18	16,589	18,443
Amounts due to fellow subsidiaries	18	3,580	3,762
Amounts due to subsidiaries of the Bank	18	2,458	1,936
Current tax liabilities		–	740
Other liabilities	29	16,210	20,793
Subordinated liabilities	31	10,406	10,548
		<u>1,011,171</u>	<u>966,717</u>
Equity			
Share capital	32	20,256	97
Reserves	33	37,086	48,275
Shareholders' equity		<u>57,342</u>	<u>48,372</u>
		<u>1,068,513</u>	<u>1,015,089</u>

Approved and authorised for issue by the Board of Directors on 4 March 2015.

Hung Pi Cheng Benjamin
Chairman

Tan Siew Boi
Director

Ling Fou Tsong
Director

Wang Wei Min
Company Secretary

The notes on pages 13 to 142 form part of these financial statements.

Consolidated statement of changes in equity**For the year ended 31 December 2014***(Expressed in millions of Hong Kong dollars)*

	Attributable to equity shareholders of the Bank												
	Share capital	Share premium	Capital redemption reserve	Cash flow hedge reserve	Available-for-sale investment reserve	Revaluation reserve	Exchange reserve	Property revaluation reserve	Retained profits	Share option equity reserve	Total	Non-controlling interests	Total
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
At 1 January 2013	97	12,477	3,804	64	102	146	370	2	29,315	380	46,757	22	46,779
Total comprehensive income	-	-	-	(97)	(50)	-	62	-	11,591	-	11,506	7	11,513
Dividend paid	-	-	-	-	-	-	-	-	(3,102)	-	(3,102)	-	(3,102)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	-	-	(115)	(115)	-	(115)
Disposal of a subsidiary	-	-	-	-	-	-	-	-	-	-	-	(29)	(29)
At 31 December 2013	97	12,477	3,804	(33)	52	146	432	2	37,804	265	55,046	-	55,046
Total comprehensive income	-	-	-	84	259	-	(63)	-	10,412	-	10,692	-	10,692
Dividend paid	-	-	-	-	-	-	-	-	(3,722)	-	(3,722)	-	(3,722)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	-	-	149	149	-	149
Amalgamation of share premium and capital redemption reserve with share capital (note 33(i))	16,281	(12,477)	(3,804)	-	-	-	-	-	-	-	-	-	-
Issuance of perpetual non-cumulative convertible preference shares, net of issuance cost (note 32)	3,878	-	-	-	-	-	-	-	-	-	3,878	-	3,878
At 31 December 2014	20,256	-	-	51	311	146	369	2	44,494	414	66,043	-	66,043

The notes on pages 13 to 142 form part of these financial statements.

Statement of changes in equity
For the year ended 31 December 2014
(Expressed in millions of Hong Kong dollars)

	Share capital HK\$'M	Share premium HK\$'M	Capital redemption reserve HK\$'M	Cash flow hedge reserve HK\$'M	Available- for-sale investment reserve HK\$'M	Retained profits HK\$'M	Share option equity reserve HK\$'M	Total HK\$'M
At 1 January 2013	97	12,477	3,804	64	111	24,970	303	41,826
Total comprehensive income	-	-	-	(97)	4	9,866	-	9,773
Dividend paid	-	-	-	-	-	(3,102)	-	(3,102)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	(125)	(125)
At 31 December 2013	<u>97</u>	<u>12,477</u>	<u>3,804</u>	<u>(33)</u>	<u>115</u>	<u>31,734</u>	<u>178</u>	<u>48,372</u>
Total comprehensive income	-	-	-	84	140	8,449	-	8,673
Dividend paid	-	-	-	-	-	(3,722)	-	(3,722)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	141	141
Amalgamation of share premium and capital redemption reserve with share capital (note 33(i))	16,281	(12,477)	(3,804)	-	-	-	-	-
Issuance of perpetual non-cumulative convertible preference shares, net of issuance cost (note 32)	3,878	-	-	-	-	-	-	3,878
At 31 December 2014	<u>20,256</u>	<u>-</u>	<u>-</u>	<u>51</u>	<u>255</u>	<u>36,461</u>	<u>319</u>	<u>57,342</u>

During the year ended 31 December 2014, the directors had declared and paid an ordinary dividend of HK\$1.9215 (2013: HK\$1.60125) per each 'A' and 'B' ordinary share totalling HK\$3,722 million (2013: HK\$3,102 million).

The notes on pages 13 to 142 form part of these financial statements.

Consolidated cash flow statement
For the year ended 31 December 2014
(Expressed in millions of Hong Kong dollars)

	<i>Note</i>	<i>2014</i> <i>HK\$'M</i>	<i>2013</i> <i>HK\$'M</i>
Operating activities			
Profit before taxation		11,965	13,356
Adjustments for:			
Impairment charges on advances to banks and customers		2,141	1,019
Advances written off net of recoveries		(1,180)	(1,013)
Unwinding of discount on loan impairment provision		(36)	(21)
Other impairment charges		911	3
Depreciation		1,422	1,251
Amortisation of intangible assets		112	141
Gains on disposal of fixed assets		(104)	(43)
Net gains on revaluation of investment properties		(306)	(127)
Share of profit of associates		(1,412)	(1,188)
Interest expense on subordinated liabilities		343	342
Expense in respect of the defined benefit plan		101	111
Fair value gains transferred from reserves on cash flow hedges		(1)	(11)
Exchange translation on subordinated liabilities		(185)	(165)
		<hr/>	<hr/>
		13,771	13,655
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions with original maturity beyond three months		(5,096)	23,787
Trading assets		12,167	(7,239)
Financial assets designated at fair value		579	1,062
Investment securities		42,148	(16,088)
Gross advances to customers		(14,599)	(45,532)
Amounts due from immediate holding company and fellow subsidiaries		(13,280)	(10,916)
Other assets		5,859	1,320
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions		17,431	4,066
Deposits from customers		34,407	60,850
Debt securities in issue		(1,498)	5,330
Financial liabilities designated at fair value		9,192	2,111
Amounts due to immediate holding company and fellow subsidiaries		(3,415)	2,673
Trading liabilities		(10,747)	479
Other liabilities		(5,783)	3,245
		<hr/>	<hr/>
Cash generated from operations		81,136	38,803
Income tax paid		(2,404)	(1,954)
		<hr/>	<hr/>
Net cash generated from operating activities		78,732	36,849
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Consolidated cash flow statement (continued)**For the year ended 31 December 2014***(Expressed in millions of Hong Kong dollars)*

	Note	2014 HK\$'M	2013 HK\$'M
Investing activities			
Dividend received from associates		36	35
Payment for additional investment in an associate		–	(68)
Payment for purchase of fixed assets		(15,395)	(6,998)
Payment for purchase of intangible assets		(111)	(253)
Proceeds from disposal of fixed assets		2,950	1,049
		<u> </u>	<u> </u>
Net cash used in investing activities		<u>(12,520)</u>	<u>(6,235)</u>
Financing activities			
Issuance of perpetual non-cumulative convertible preference shares		3,878	–
Interest paid on subordinated liabilities		(330)	(331)
Dividend paid to shareholders of the Bank		(3,722)	(3,102)
		<u> </u>	<u> </u>
Net cash used in financing activities		<u>(174)</u>	<u>(3,433)</u>
Net increase in cash and cash equivalents		66,038	27,181
Cash and cash equivalents at 1 January		168,807	141,146
Effect of foreign exchange		(1,995)	480
		<u> </u>	<u> </u>
Cash and cash equivalents at 31 December	34	<u>232,850</u>	<u>168,807</u>
Cash flows from operating activities include:			
Interest received		18,877	18,369
Interest paid		5,100	5,107
Dividends received		20	24
		<u> </u>	<u> </u>

The notes on pages 13 to 142 form part of these financial statements.

Notes to the financial statements

(Expressed in millions of Hong Kong dollars)

1 Principal activities

The principal activities of Standard Chartered Bank (Hong Kong) Limited (the “Bank”) and its subsidiaries (together referred to as the “Bank and its subsidiaries”) are the provision of banking and related financial services.

2 Significant accounting policies

(a) Statement of compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”) and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. As HKFRSs are consistent with International Financial Reporting Standards (“IFRSs”), which collective term includes all applicable individual International Financial Reporting Standards, International Accounting Standards (“IAS”) and Interpretations issued by the International Accounting Standards Board (“IASB”), these financial statements also comply with IFRSs.

(b) Basis of preparation of the financial statements

(i) Basis of Preparation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries made up to 31 December 2014.

The consolidated and the Bank’s financial statements have been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale assets, and financial assets and liabilities (including derivatives) at fair value through profit or loss.

The preparation of financial statements in conformity with adopted HKFRS/IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank and its subsidiaries’ accounting policies. Actual results may differ from these estimates. The significant judgements made by management in applying the accounting policies and key sources of uncertainty were the same as those applied to the consolidated financial statements as at and for the year ended 31 December 2013.

The accounting policies set out below have been applied consistently across the Bank and its subsidiaries and to all periods presented in these financial statements.

(ii) Consolidated Financial Statements

During the year, the Bank had subordinated debts in issue. These subordinated debts were issued under a note issuance programme which is listed on the Stock Exchange of Hong Kong. Consequently, the Bank is required to produce consolidated financial statements in accordance with HKAS 27/IAS 27 “Consolidated and Separate Financial Statements”.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(c) Subsidiaries and non-controlling interests**

Subsidiaries are all entities which the Bank and its subsidiaries control. The Bank and its subsidiaries control an entity when they are exposed to, or have rights to, variable returns from their involvement with the entity and have the ability to affect those returns through their power over the investee. Subsidiaries are fully consolidated from the date on which the Bank and its subsidiaries effectively obtain control. They are de-consolidated from the date that control ceases, and where any interest in the subsidiary remains, this is remeasured to its fair value and the change in carrying amount is recognised in the income statement. Details of the Bank's principal subsidiaries are given in note 19.

Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Non-controlling interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Bank, whether directly or indirectly through subsidiaries, and in respect of which the Bank and its subsidiaries have not agreed any additional terms with the holders of those interests which would result in the Bank and its subsidiaries as a whole having a contractual obligation in respect of those interests that meet the definition of a financial liability. Non-controlling interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity shareholders of the Bank. Non-controlling interests are presented on the face of the consolidated income statement and the consolidated statement of comprehensive income as an allocation of the total profit or loss and total comprehensive income for the year between non-controlling interests and the equity shareholders of the Bank.

Where losses applicable to the non-controlling interest exceed its interest in the equity of a subsidiary, the excess, and any further losses applicable to the non-controlling interest, are charged against the Bank and its subsidiaries' interest except to the extent that the non-controlling interest has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Bank and its subsidiaries' are allocated all such profits until the non-controlling interest's share of losses previously absorbed by the Bank and its subsidiaries have been recovered.

In the Bank's balance sheet, investments in subsidiaries are stated at cost less impairment losses, if any.

(d) Associates and joint arrangements

Associates are entities in respect of which the Bank has significant influence, but not control, over the financial and operating policies and procedures, generally accompanying a shareholding of between 20 percent and 50 percent of the voting rights.

Joint arrangements are where two or more parties either have rights to the assets, and obligations of the joint arrangement (joint operations) or have rights to the net assets of the joint arrangement (joint venture). The Bank and its subsidiaries evaluate the contractual terms of joint arrangements to determine whether a joint arrangement is a joint operation or a joint venture. At 31 December 2014, the Bank and its subsidiaries have an insignificant contractual interest in a joint venture but do not have any contractual interest in joint operations. Details of the Bank and its subsidiaries' interest in associates are provided in note 20.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(d) Associates and joint arrangements (continued)

Investments in associates and joint ventures are accounted for using the equity method of accounting in the consolidated financial statements and are initially recognised at cost. The Bank and its subsidiaries' investment in associates and joint ventures includes goodwill identified on acquisition and accumulated impairment loss.

The Bank and its subsidiaries' share of its associates' and joint ventures' post-acquisition profits or losses are recognised in the income statement, and the share of post-acquisition movements in other comprehensive income are recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment in the consolidated balance sheet. When the Bank and its subsidiaries' share of losses in an associate or a joint venture is equal to or exceeds its interest in the associate and joint venture, including any other unsecured receivables, the Bank and its subsidiaries do not recognise further losses, unless they have incurred obligations or made payments on behalf of the associate and joint venture.

Unrealised gains and losses on transactions between the Bank and its associates and joint ventures are eliminated to the extent of the Bank and its subsidiaries' interest in the associates and joint ventures.

In the Bank's balance sheet, investment in associates and joint ventures are stated at cost less impairment losses and dividends from pre-acquisition profits received prior to 1 January 2009, if any.

(e) Intangible assets

(i) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Bank and its subsidiaries' share of the net identifiable assets and contingent liabilities of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in "Goodwill and intangible assets". Goodwill on acquisitions of associates is included in "Interest in associates".

Goodwill included in "Goodwill and intangible assets" is tested annually for impairment and carried at cost less any accumulated impairment losses. Detailed calculations are performed based on discounting expected pre-tax cash flows of the relevant cash generating units and discounting these at an appropriate discount rate, the determination of which requires the exercise of judgement. Goodwill is allocated to cash generating units for the purpose of impairment testing. Cash generating units represent the lowest level within the Bank and its subsidiaries at which the goodwill is monitored for internal management purposes. Note 22 sets out the major cash-generating units to which goodwill has been allocated.

(ii) Acquired intangibles

At the date of acquisition of a subsidiary or associate, intangible assets which are deemed separable and that arise from contractual or other legal rights are capitalised and included within the net identifiable assets acquired. These intangible assets are initially measured at fair value, which reflects market expectations of the probability that the future economic benefits embodied in the asset will flow to the entity, and are amortised on the basis of their expected useful lives (4 to 16 years). At each balance sheet date, these assets are assessed for indicators of impairment. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, the asset is written down immediately.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(e) Intangible assets (continued)****(iii) Computer software**

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs associated with the development of software are capitalised where it is probable that it will generate future economic benefits in excess of its cost. Computer software costs are amortised on the basis of expected useful life (5 years). Costs associated with maintaining software are recognised as an expense as incurred. At each balance sheet date, these assets are assessed for indicators of impairment. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, the asset is written down immediately.

(f) Investment properties

Investment properties are land and buildings which are owned either to earn rental income or for long term investments or for both. Investment properties are stated in the balance sheet at fair value. Any gains or losses arising from a change in fair value or from the disposal of an investment property is recognised in the income statement.

(g) Other property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment, if any. Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation on fixed assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

- Buildings, leasehold land and leasehold improvements, are depreciated over the shorter of their estimated useful lives, being 50 years from the date of completion, and the unexpired terms of the lease.
- Equipment and motor vehicles, are depreciated over 3 to 15 years.
- Aircraft and vessels, are depreciated over 25 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. At each balance sheet date, these assets are assessed for indicators of impairment. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, the asset is written down immediately.

Gains and losses on disposals are included in the income statement.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(h) Leases**

Where the Bank and its subsidiaries are the lessees

The leases entered into by the Bank and its subsidiaries are primarily operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the leases.

Where the Bank and its subsidiaries are the lessors

When assets are leased to customers under finance leases, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return ignoring tax cash flows.

Assets leased to customers under operating leases are included within Fixed assets and depreciated over their estimated useful lives. Rental income on these leased assets is recognised in the income statement on a straight-line basis unless another systematic basis is more representative.

(i) Financial assets and liabilities (excluding derivatives)

Financial assets are classified into the following categories: financial assets held at fair value through profit or loss, loans and receivables, and available-for-sale financial assets. Financial liabilities are classified as either held at fair value through profit or loss, or at amortised cost. Management determines the classification of the financial assets and liabilities on initial recognition or, where appropriate, at the time of reclassification.

(i) Financial assets and liabilities held at fair value through profit or loss

This category has two sub-categories: financial assets and liabilities held for trading, and those designated at fair value through profit or loss at inception. A financial asset or liability is classified as trading if acquired principally for the purpose of selling or repurchasing in the short term or is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking.

Financial assets and liabilities may be designated at fair value through profit or loss when:

- the designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities on a different basis, or
- a group of financial assets and/or liabilities is managed and its performance evaluated on a fair value basis, or
- assets or liabilities include embedded derivatives and such derivatives are not recognised separately.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(i) Financial assets and liabilities (excluding derivatives) (continued)****(ii) Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and it is expected that substantially all of the initial investment will be recovered, other than because of credit deterioration.

(iii) Available-for-sale assets

Available-for-sale assets are those non-derivative financial assets intended to be held for an indefinite period of time, which may be sold in response to liquidity requirements or changes in interest rates, exchange rates, commodity prices or equity prices.

(iv) Financial liabilities held at amortised cost

Financial liabilities, which include borrowings, not classified as held at fair value through profit or loss are classified as amortised cost instruments.

Initial recognition

Purchases and sales of financial assets and liabilities held at fair value through profit or loss and financial assets classified as available-for-sale are initially recognised using trade date accounting (the date on which the Bank and its subsidiaries commit to purchase or sell the asset). Loans and receivables are recognised when cash is advanced to the borrowers. All financial instruments are initially recognised at fair value, which is normally the transaction price plus, for those financial assets and liabilities not carried at fair value through profit and loss, directly attributable transaction costs.

Subsequent measurement

Financial assets and liabilities held at fair value through profit or loss are subsequently carried at fair value, with gains and losses arising from changes in fair value taken directly to the income statement.

Available-for-sale financial assets are subsequently carried at fair value, with gains and losses arising from changes in fair value taken to a separate component of equity until the asset is sold, or is impaired, when the cumulative gain or loss is transferred to the income statement.

Loans and receivables are subsequently carried at amortised cost using the effective interest method.

Financial liabilities other than those held at fair value through profit or loss are subsequently stated at amortised cost, with any difference between proceeds net of directly attributable transaction costs and the redemption value recognised in the income statement over the period of the borrowings using the effective interest method.

In addition to these instruments, the carrying value of a financial instrument carried at amortised cost that is the hedged item in a qualifying fair value hedge relationship is adjusted by the fair value gain or loss attributable to the hedged risk.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial assets and liabilities (excluding derivatives) (continued)

Fair value of financial assets and liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal market or in the absence of a principal market the most advantageous market to which the Bank and its subsidiaries have access at that date. The fair value of a liability reflects its non-performance risk.

The fair values of quoted financial assets or financial liabilities in active markets are based on current prices. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. If the market for a financial asset or financial liability and for unlisted securities, is not active, the Bank and its subsidiaries establish fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Reclassifications

Reclassifications of financial assets, other than as disclosed below, or of financial liabilities between measurement categories are not permitted following their initial recognition.

Held for trading non-derivative financial assets can only be transferred out of the held at fair value through profit or loss category in the following circumstances: (i) to the available-for-sale category, where, in rare circumstances, they are no longer held for the purpose of selling or repurchasing in the near term; or (ii) to the loans and receivables category, where they are no longer held for the purpose of selling or repurchasing in the near term and they would have met the definition of a loan and receivable on initial recognition and the Bank and its subsidiaries have the intent and ability to hold the assets for the foreseeable future or until maturity.

Financial assets can only be transferred out of the available-for-sale category to the loans and receivables category, where they would have met the definition of a loan and receivable on initial recognition and the Bank and its subsidiaries have the intent and ability to hold the assets for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. For financial assets reclassified out of the available-for-sale category into loans and receivables, any gain or loss on those assets recognised in shareholders' equity prior to the date of reclassification is amortised to the income statement over the remaining life of the financial asset, using the effective interest method.

Renegotiated loans

Loans and receivables with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank and its subsidiaries have made concessions that they would not otherwise consider. Renegotiated loans and receivables are subject to ongoing monitoring to determine whether they remain impaired or past due.

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank and its subsidiaries have transferred substantially all risks and rewards of ownership.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(i) Financial assets and liabilities (excluding derivatives) (continued)**

Financial liabilities are derecognised when they are extinguished, i.e. when the obligation is discharged, cancelled or expires. If the Bank and its subsidiaries purchase their own debt, it is removed from the balance sheet, and the difference between the carrying amount of the liability and the consideration paid is included in 'Other operating income'.

(j) Derivative financial instruments and hedge accounting

Derivatives are financial instruments that derive their value in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk and indices. Derivatives are categorised as trading unless they are designated as hedging instruments.

Derivative contracts are initially recognised at fair value on the date on which they are entered into and are subsequently re-measured at their fair value. Fair values are obtained from market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and option pricing models, as appropriate. All derivatives are carried as assets when their fair values are positive and as liabilities when their fair values are negative.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Bank and its subsidiaries designate certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities, or commitments (fair value hedge); or, (2) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Bank and its subsidiaries document, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Bank and its subsidiaries also document the assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

(i) Fair value hedge

Changes in the fair value of derivatives that are designated and that qualify as fair value hedging instruments are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to the income statement over the period to maturity or derecognition.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(j) Derivative financial instruments and hedge accounting (continued)****(ii) Cash flow hedge**

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedging instruments are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Derivatives that do not qualify for hedge accounting

Certain derivative transactions do not qualify for hedge accounting. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

(k) Impairment of financial assets

The Bank and its subsidiaries assess at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The following factors are considered in assessing objective evidence of impairment:

- whether the counterparty is in default of principal or interest payments;
- a counterparty files for bankruptcy protection (or the local equivalent) where this would avoid or delay repayment of its obligation;
- the Bank and its subsidiaries file to have the counterparty declared bankrupt or file a similar order in respect of a credit obligation;
- the Bank and its subsidiaries consent to a restructuring of the obligation, resulting in a diminished financial obligation, demonstrated by a material forgiveness of debt or postponement of scheduled payments;
- the Bank and its subsidiaries sell a credit obligation at a material credit-related economic loss; or

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment of financial assets (continued)

- there is observable data indicating that there is a measurable decrease in the estimated future cash flows of a group of financial assets, although the decrease cannot yet be identified with specific individual financial assets.

Assets carried at amortised cost

The Bank and its subsidiaries first assess whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank and its subsidiaries determine that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank and its subsidiaries may measure impairment on the basis of an instrument's fair value using observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are based on the probability of default inherent within the portfolio of impaired loans or receivables and the historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

To the extent a loan is irrecoverable, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(k) Impairment of financial assets (continued)***Available-for-sale assets*

A significant or prolonged decline in the fair value of an equity security below its cost is considered, amongst other factors in determining whether the equity security is impaired. Where objective evidence of impairment exists for available-for-sale financial assets, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement) is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(l) Offsetting financial transactions

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

(m) Fiduciary activities

The Bank and its subsidiaries commonly act as trustee and in other fiduciary capacities that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. The assets and income arising thereon are excluded from these financial statements, as they are not assets and income of the Bank and its subsidiaries.

(n) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash and balances with banks, central banks and other financial institutions, trading assets, placements with banks and other financial institutions, and amounts due from immediate holding company and fellow subsidiaries.

(o) Revenue recognition**(i) Interest income and expense**

Interest income and expense on available-for-sale assets, financial assets or liabilities held at amortised cost and financial assets and liabilities held at fair value through profit or loss excluding derivatives is recognised in the income statement using the effective interest rate method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank and its subsidiaries estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all amounts paid or received between parties to the contract that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(o) Revenue recognition (continued)

(i) Interest income and expense (continued)

Where the estimates of cash flows have been revised, the carrying amount of the financial asset or liability is adjusted to reflect the actual and revised cash flows, discounted at the instrument's original effective interest rate. The adjustment is recognised as interest income or expense in the period in which the revision is made.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised at the original effective interest rate of the financial asset applied to the impaired carrying amount.

(ii) Fees and commissions

Fees and commissions are generally recognised on an accrual basis when the service has been provided or significant act performed. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank and its subsidiaries have retained no part of the loan package for itself or have retained a part at the same effective interest rate as for the other participants. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis.

(iii) Other income from financial assets and liabilities

Gains and losses arising from changes in the fair value of financial assets and liabilities held at fair value through profit or loss, as well as any interest receivable or payable, are included in the income statement in the period in which they arise.

Gains and losses arising from changes in the fair value of available-for-sale financial assets other than foreign exchange gains and losses from monetary items, are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement.

Dividends on equity instruments are recognised in the income statement when the Bank and its subsidiaries' right to receive payment is established.

(p) Income tax

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and that are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(p) Income tax (continued)**

Current and deferred tax relating to items which are charged or credited directly to equity, are credited or charged directly to equity and are subsequently recognised in the income statement together with the current or deferred gain or loss.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if the Bank and its subsidiaries have a legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Bank or its subsidiaries intend either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities for which a legal right of set off exists.

(q) Provisions

Provisions for restructuring costs and legal claims are recognised when the Bank and its subsidiaries have a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

(r) Employee benefits**(i) Short term employee benefits**

Salaries, annual bonuses, and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees.

(ii) Retirement benefit obligations

The Bank and its subsidiaries operate a number of defined contribution and defined benefit plans.

For defined contribution plans, the Bank and its subsidiaries pay contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis, and such amounts are charged to operating expenses. The Bank and its subsidiaries have no further payment obligations once the contributions have been paid.

For funded defined benefit plans, the net liability recognised in the balance sheet represents the present value of the defined benefit obligations at the balance sheet date less the fair value of plan assets. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligations is determined by discounting the estimated future cash outflows using an interest rate equal to the yield on government bonds that are denominated in the currency in which the benefits will be paid, and that have a term to maturity approximating to the term of the related pension liability.

Actuarial gains and losses that arise are recognised in shareholders' equity and presented in the consolidated statement of other comprehensive income in the period they arise. Past service costs are recognised immediately to the extent that benefits are vested and are otherwise recognised over the average period until benefits are vested on a straight-line basis. Current service costs and any past service costs, together with the net interest expense on the net defined benefit liability, are charged to operating expenses.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(r) Employee benefits (continued)

(ii) Retirement benefit obligations (continued)

The Bank determines the net interest expense on the net defined benefit liability for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then net defined benefit liability, taking into account any changes in the net defined benefit liability during the year as a result of contributions and benefit payment.

(iii) Share-based compensation

The Standard Chartered PLC Group (“Group”) operates equity-settled share-based compensation plans in which the Bank and its subsidiaries’ employees participate. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. For deferred share awards granted as part of an annual performance award, the expense is recognised over the period from the start of the performance period to the vesting date. For all other awards the expense is recognised over the period from the start of the date of grant to the vesting date.

For equity-settled awards, the total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and growth targets). The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments is estimated using an appropriate valuation technique, such as a binomial option pricing model.

Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. At each balance sheet date, the Bank and its subsidiaries revise its estimates of the number of options that are expected to vest. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period. Forfeitures prior to vesting attributable to factors other than the failure to satisfy a non-market vesting condition are treated as a cancellation and the remaining unamortised charge is debited to the income statement at the time of cancellation.

(s) Translation of foreign currencies

Foreign currency transactions are translated into Hong Kong dollars using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the income statement.

Non-monetary assets and liabilities are translated at historical exchange rates if held at historical cost or year-end exchange rates if held at fair value, and the resulting foreign exchange gains and losses are recognised in either the income statement or shareholders’ equity depending on the treatment of the gain or loss on the asset or liability.

The results and financial position of all foreign operations that have a functional currency different from the Bank’s presentation currency are accounted for as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the balance sheet date.
- income and expenses for each income statement are translated at average exchange rates or at rates on the date of the transaction where exchange rates fluctuate significantly; and

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(s) Translation of foreign currencies (continued)**

- all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to other comprehensive income. When a foreign operation is sold, the exchange differences are recognised in the income statement as part of the gain or loss on disposal.

(t) Related parties

For the purposes of these financial statements, parties are considered to be related to the Bank and its subsidiaries if the Bank and its subsidiaries have the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Bank and its subsidiaries and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include (i) associates and joint ventures of the Group, (ii) entities which are under the significant influence of related parties of the Bank where those parties are individuals, and (iii) post-employment benefit plans which are for the benefit of employees of the Bank or of any entity that is a related party of the Bank.

(u) Segment reporting

Operating segments, and the amounts of each segment item reported in the financial statements, are identified from the financial information provided regularly to the Bank and its subsidiaries' most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Bank and its subsidiaries' various lines of business and geographical locations.

(v) Sale and repurchase agreements

Securities sold subject to repurchase agreements ("repos") remain on the balance sheet; the counterparty liability is included in "Deposits and balances of banks and other financial institutions", "Deposits from customers" or "Amounts due to Group companies", as appropriate. Securities purchased under agreements to re-sell ("reverse repos") are not recognised on the balance sheet and the consideration paid is recorded in "Advances to customers", "Placements with banks and other financial institutions" or "Amounts due from Group Companies" as appropriate. The difference between the sale and repurchase price is treated as interest and recognised over the life of the agreement.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income.

(w) Assets held for sale

Non-current assets (such as property) and disposal groups (including both the assets and liabilities of the disposal groups) are classified as held for sale and measured at the lower of their carrying amount and fair value less cost to sell when: (i) their carrying amounts will be recovered principally through sale; (ii) they are available for sale in their present condition; and (iii) their sale is highly probable.

Immediately before the initial classification as held for sale, the carrying amounts of the assets (or assets and liabilities in the disposal group) are measured in accordance with the applicable accounting policies described above.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***3 Changes in accounting policies***Amendments to HKFRSs/IFRSs and new interpretation*

The HKICPA/IASB has issued the following amendments to HKFRSs/IFRSs and one new interpretation that are first effective for the current accounting period commencing 1 January 2014.

- Amendment to HKAS 32/IAS 32 *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities*
- Amendments to HKAS 36/IAS 36 *Recoverable Amount Disclosures for Non-Financial Assets*
- Amendments to HKAS 39/IAS 39 *Financial Instruments: Recognition and Measurement: Novation of Derivatives and Continuation of Hedge Accounting*
- HK(IFRIC)-Int 21/IFRIC 21 *Levies*

The Bank and its subsidiaries adopted the above amendments and new interpretation to existing accounting standards from 1 January 2014. The application of these amendments and interpretation did not have a material impact on these consolidated financial statements.

4 Operating profit

The operating profit for the year is stated after taking into account the following:

	2014 HK\$'M	2013 HK\$'M
(a) Interest income		
Interest income on listed securities	1,023	421
Interest income on unlisted securities	1,474	2,024
Other interest income	16,402	16,069
	<hr/>	<hr/>
Amount shown in the income statement	18,899	18,514
Less: interest income arising from trading assets	(401)	(373)
Less: interest income on financial assets designated at fair value	(57)	(67)
	<hr/>	<hr/>
Total interest income on financial assets that are not measured at fair value through profit or loss	18,441	18,074
	<hr/> <hr/>	<hr/> <hr/>

Other interest income includes interest income on unwinding of discounts on loan impairment provision of HK\$36 million (note 16) (2013: HK\$21 million), and fair value gains of HK\$1 million transferred from reserves on cash flow hedges (2013: HK\$11 million).

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***4 Operating profit (continued)**

	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
(b) Interest expense		
Interest expense on customer deposits, deposits of banks, certificates of deposit issued, debt securities issued, trading liabilities and financial liabilities designated at fair value	4,826	4,932
Interest expense on subordinated liabilities	343	342
	<u>5,169</u>	<u>5,274</u>
Amount shown in the income statement	5,169	5,274
Less: interest expense arising from trading liabilities	(89)	(110)
Less: interest expense arising from financial liabilities designated at fair value	(64)	(33)
	<u>(64)</u>	<u>(33)</u>
Total interest expense on financial liabilities that are not measured at fair value through profit or loss	<u>5,016</u>	<u>5,131</u>
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
(c) Net fee and commission income		
Net fee and commission income (other than amounts included in determining the effective interest rate) arising from financial assets or financial liabilities that are not held for trading or designated at fair value		
– fee and commission income	3,241	3,496
– fee and commission expense	165	169
	<u>3,241</u>	<u>3,496</u>
Net fee and commission income from trust and other fiduciary activities where the Bank and its subsidiaries hold or invest assets on behalf of its customers		
– fee and commission income	512	494
– fee and commission expense	123	120
	<u>512</u>	<u>494</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***4 Operating profit (continued)**

	2014 HK\$'M	2013 HK\$'M
(d) Net trading income		
Gains less losses from dealing in foreign currencies	988	2,527
Gains less losses from trading securities	172	(68)
Gains less losses from other dealing activities	(137)	1,070
	<u>1,023</u>	<u>3,529</u>
Amount shown in the income statement	1,023	3,529
Add: interest income arising from trading assets	401	373
Less: interest expense arising from trading liabilities	(89)	(110)
	<u>1,335</u>	<u>3,792</u>
Net income from trading instruments	<u>1,335</u>	<u>3,792</u>
	2014 HK\$'M	2013 HK\$'M
(e) Net gains from financial instruments designated at fair value		
Net gains as shown in the income statement	641	124
Add: interest income arising from financial assets designated at fair value	57	67
Less: interest expense arising from financial liabilities designated at fair value	(64)	(33)
	<u>634</u>	<u>158</u>
Net gains from financial instruments designated at fair value	<u>634</u>	<u>158</u>
	2014 HK\$'M	2013 HK\$'M
(f) Other operating income		
Rental income from operating lease assets	2,662	2,089
Dividend income from listed available-for-sale securities	–	1
Dividend income from unlisted available-for-sale securities	20	23
Gains on disposal of fixed assets	104	43
Net (losses)/gains on disposal of financial instruments measured at amortised cost	(31)	17
Net gains on revaluation of investment properties (note 21)	306	127
Others	60	85
	<u>3,121</u>	<u>2,385</u>
Other operating income	<u>3,121</u>	<u>2,385</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***4 Operating profit (continued)**

	2014 HK\$'M	2013 HK\$'M
(g) Operating expenses		
Staff costs		
– contributions to defined contribution plans	223	208
– expense in respect of the defined benefits plan (note 30(c))	101	111
– equity-settled share-based payment expenses	341	269
– salaries and other staff costs	6,259	6,036
Depreciation (note 21)	1,422	1,251
Premises and equipment expense, excluding depreciation		
– rental of premises	935	839
– others	406	330
Amortisation		
– other intangible assets (note 22)	112	141
Auditor's remuneration	17	17
Others	5,027	4,381
	<u>14,843</u>	<u>13,583</u>

5 Net gains from disposal of available-for-sale securities

	2014 HK\$'M	2013 HK\$'M
Net gains transferred from reserves	19	17
	<u>19</u>	<u>17</u>

6 Impairment charges

	2014 HK\$'M	2013 HK\$'M
(a) Impairment charges on advances to banks and customers		
Individual impairment provisions (note 16)		
– additions	2,574	1,292
– releases	(40)	(131)
– recoveries	(242)	(240)
	<u>2,292</u>	<u>921</u>
Portfolio impairment charges (note 16)	(151)	98
	<u>2,141</u>	<u>1,019</u>
(b) Other impairment charges		
Charges for an interest in an associate	620	–
Charges for goodwill and intangible assets	291	–
Charges/(releases) relating to investment securities classified as:		
– available-for-sale – equity shares	–	15
– loans and receivables – debt securities	–	(12)
	<u>911</u>	<u>3</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***7 Taxation in the consolidated income statement****(a) Taxation in the consolidated income statement represents:**

	2014 HK\$'M	2013 HK\$'M
<i>Current tax</i>		
Hong Kong profits tax	1,609	1,881
Overseas taxation	31	31
(Over)/under-provision in respect of prior years	(255)	205
	<u>1,385</u>	<u>2,117</u>
<i>Deferred tax (note 27)</i>		
Origination/reversal of temporary differences	126	75
Under/(over)-provision in respect of prior years	49	(211)
	<u>175</u>	<u>(136)</u>
	<u>1,560</u>	<u>1,981</u>

The provision for Hong Kong profits tax for 2014 is calculated at 16.5% (2013: 16.5%) of the estimated assessable profits for the year. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

(b) Reconciliation between tax expenses and accounting profit at applicable tax rates:

	2014 HK\$'M	2013 HK\$'M
Profit before taxation	<u>11,965</u>	<u>13,356</u>
Notional tax on profit before taxation, calculated at		
Hong Kong profits tax rate of 16.5%	1,974	2,204
Tax effect of non-deductible expenses	289	130
Tax effect of non-taxable revenue	(480)	(334)
Over-provision in prior years	(206)	(6)
Tax effect of different tax rates of subsidiaries operating in other jurisdictions	(20)	(5)
Others	3	(8)
	<u>1,560</u>	<u>1,981</u>
Actual tax expense	<u>1,560</u>	<u>1,981</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

8 Directors' remuneration

Directors' remuneration disclosed pursuant to section 161 of the Hong Kong Companies Ordinance is as follows:

	<i>Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Fees	1	1
Salaries and other emoluments	79	88
	<u>80</u>	<u>89</u>

9 Segmental reporting

The Bank and its subsidiaries manage its businesses by four client segments: Corporate and Institutional, Commercial, Private Banking and Retail:

- **Corporate & Institutional (C&I) Clients** comprises Global Corporates (major multinational corporations and large business groups which have sophisticated, cross-border needs requiring high levels of international service); Local Corporates (typically clients with operations in three geographies or less); and Financial Institutions (Banks, Investor clients, Insurance companies, Broker Dealers, Public Sector names (including Central Banks, Sovereign Wealth Funds and Development Organisations) and other types of financial institutions). The majority of C&I client income is generated by Transaction Banking, Financial Markets and Corporate Finance products.
- **Commercial Clients** segment serves medium-sized business clients and Mid Markets clients providing products across Transaction Banking, Financial Markets and Lending.
- **Private Banking Clients** segment is dedicated to giving high net worth clients highly personalised service and a comprehensive suite of products and services tailored to meet their financial needs. Income from Private Banking clients primarily relates to Wealth Management and Retail products.
- **Retail Clients** comprises:
 - Priority & International clients, managing and servicing High Value Segment customers and delivering a distinct and differentiated customer experience to them;
 - Personal & Preferred clients, providing banking products and services to a broader consumer market; and
 - Business clients, serving small business clients, sole proprietors and private companies, offering solutions such as working capital, business expansion, businesses protection and yield enhancement.

Besides the four client segments, trading and proprietary activities undertaken by the Bank are classified as Own Account. In addition, certain items which do not fall within the client segments and Own Account, including unallocated central costs are reported in "Other Banking". Financial information is presented internally to the Bank's senior management using these segments.

The Bank and its subsidiaries comprise only one geographical segment as over 90% of the business is based in Hong Kong. Geographical segment is classified by the location of the principal operations of the subsidiary or, in the case of the Bank, the location of the branch responsible for reporting the results or advancing the funds.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***9 Segmental reporting (continued)****(a) Segment results, assets and liabilities**

Revenue and expenses are allocated to the reportable segments with reference to income generated by those segments and the expenses incurred by those segments or which otherwise arise from the depreciation or amortisation of assets attributable to those segments.

In January 2014 Standard Chartered PLC announced a change to its organisation structure effective 1 April 2014. In accordance with HKFRS 8 / IFRS 8 *Operating Segments*, the presentation of the Bank and its subsidiaries' full year results have been updated to reflect the new client segments – Corporate & Institutional, Commercial, Private Banking and Retail.

Prior year figures have been restated in the new client segments for comparative purpose. The restatements have no impact on the Bank and its subsidiaries' overall income statement and balance sheet.

2014	<i>Corporate & Institutional Clients HK\$'M</i>	<i>Commercial Clients HK\$'M</i>	<i>Private Banking Clients HK\$'M</i>	<i>Retail Clients HK\$'M</i>	<i>Own Account HK\$'M</i>	<i>Other Banking HK\$'M</i>	<i>Consolidated Total HK\$'M</i>
<i>Operating income</i>							
– Net interest income	3,949	1,195	421	6,477	2,271	(111)	14,202
– Other operating income	9,120	1,444	540	4,843	(320)	22	15,649
	13,069	2,639	961	11,320	1,951	(89)	29,851
Operating expenses (note)	(5,915)	(1,403)	(784)	(5,491)	(218)	91	(13,720)
Operating profit before impairment	7,154	1,236	177	5,829	1,733	2	16,131
Impairment charges	(1,449)	(492)	(1)	(1,108)	–	(271)	(3,321)
Profit before taxation	5,705	744	176	4,721	1,733	(269)	12,810
Segment assets	349,407	32,512	28,919	250,720	379,330	52,779	1,093,667
Segment liabilities	419,706	59,436	58,592	355,958	61,612	93,220	1,048,524

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***9 Segmental reporting (continued)****(a) Segment results, assets and liabilities (continued)**

2013	Corporate & Institutional Clients HK\$'M	Commercial Clients HK\$'M	Private Banking Clients HK\$'M	Retail Clients HK\$'M	Own Account HK\$'M	Other Banking HK\$'M	Consolidated Total HK\$'M
<i>Operating income</i>							
- Net interest income	3,939	1,330	367	6,395	1,731	(131)	13,631
- Other operating income	8,617	2,048	458	3,580	(33)	19	14,689
	12,556	3,378	825	9,975	1,698	(112)	28,320
Operating expenses (note)	(5,653)	(1,362)	(720)	(5,149)	(215)	47	(13,052)
Operating profit before impairment	6,903	2,016	105	4,826	1,483	(65)	15,268
Impairment (charges)/releases	69	(47)	(1)	(1,061)	(37)	-	(1,077)
Profit before taxation	6,972	1,969	104	3,765	1,446	(65)	14,191
Segment assets	318,738	50,340	23,295	230,714	384,596	48,893	1,056,576
Segment liabilities	385,585	108,898	54,824	310,307	74,290	86,981	1,020,885

(note): Operating expenses in Corporate & Institutional Clients segment included depreciation charges of HK\$1,214 million (2013: HK\$1,005 million) for commercial aircraft and vessels leased to customers under operating leases.

(b) Reconciliation of reportable segment operating income, profit before taxation, assets and liabilities

	Consolidated	
	2014 HK\$'M	2013 HK\$'M
Operating income		
Reportable segment revenue	29,851	28,320
Income relating to Financial Market products	(1,776)	(1,434)
Cost of free funds	108	175
Others	265	(288)
Total operating income	28,448	26,773

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***9 Segmental reporting (continued)****(b) Reconciliation of reportable segment operating income, profit before taxation, assets and liabilities (continued)**

	<i>Consolidated</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Profit before taxation		
Reportable segment profit before taxation	12,810	14,191
Income relating to Financial Market products	(1,776)	(1,434)
Cost of free funds	108	175
Reallocations of impairment charges	290	42
Others	533	382
	<u>11,965</u>	<u>13,356</u>
Profit before taxation	<u>11,965</u>	<u>13,356</u>
	<i>Consolidated</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Assets		
Reportable segment assets	1,093,667	1,056,576
Assets of group companies not included in consolidated total assets	(2,872)	(3,153)
Amounts due from immediate holding company and fellow subsidiaries	116,324	88,869
Others	(128,077)	(118,060)
	<u>1,079,042</u>	<u>1,024,232</u>
Total assets	<u>1,079,042</u>	<u>1,024,232</u>
	<i>Consolidated</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Liabilities		
Reportable segment liabilities	1,048,524	1,020,885
Liabilities of group companies not included in consolidated total liabilities	(1,415)	(2,521)
Amounts due to immediate holding company and fellow subsidiaries	20,853	22,865
Others	(54,963)	(72,043)
	<u>1,012,999</u>	<u>969,186</u>
Total liabilities	<u>1,012,999</u>	<u>969,186</u>

Income and profit before taxation recognised in the consolidated financial statements represent an arm's length compensation for the services provided and risks borne. For internal management reporting purposes, income and profit before taxation are allocated on a global perspective. In addition, for internal management reporting purposes, a charge is allocated to reportable segments for the use of interest-free funds.

Reportable segment assets and liabilities include assets and liabilities which are not booked on the Bank and its subsidiaries' balance sheets but which contribute to the reportable segment's income and profit before taxation.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***10 Cash and balances with banks, central banks and other financial institutions**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Cash in hand	1,905	1,819	1,905	1,798
Balances with central banks	29,732	14,231	29,732	14,231
Balances with banks and other financial institutions	21,439	10,835	21,427	10,668
	<u>53,076</u>	<u>26,885</u>	<u>53,064</u>	<u>26,697</u>

11 Placements with banks and other financial institutions**(a) Placements with banks and other financial institutions**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross placements with banks and other financial institutions				
– maturing within one month	85,928	63,688	85,917	63,679
– maturing between one month to one year	58,053	60,600	58,051	60,598
– maturing between one year to five years	1,789	1,580	1,789	1,580
	<u>145,770</u>	<u>125,868</u>	<u>145,757</u>	<u>125,857</u>
Less: impairment provision – individually assessed (note 16(b))	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>
	<u>145,770</u>	<u>125,868</u>	<u>145,757</u>	<u>125,857</u>

(b) Impaired placements with banks and other financial institutions

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross impaired advances to banks	–	46
Impairment provision – individually assessed	–	–
	<u>–</u>	<u>46</u>
Gross impaired advances to banks as a % of gross advances to banks	<u>–</u>	<u>0.04%</u>

There is no collateral held against impaired advances to banks.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***12 Hong Kong SAR Government certificates of indebtedness and currency notes in circulation**

The Hong Kong Special Administrative Region currency notes in circulation are secured by the deposit of funds in respect of which the Government of Hong Kong Special Administrative Region certificates of indebtedness are held.

13 Trading assets

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Trading securities	20,768	33,985
Advances to customers	1,604	3,983
Positive fair values of trading derivatives	1,016	893
	<u>23,388</u>	<u>38,861</u>
Trading securities:		
Treasury bills	3,016	13,230
Certificates of deposit held	374	1,769
Debt securities	15,841	17,882
Equity securities	1,537	1,104
	<u>20,768</u>	<u>33,985</u>
Issued by:		
Central governments and central banks	14,181	25,376
Public sector entities	–	10
Banks and other financial institutions	1,285	2,485
Corporate entities	5,302	6,114
	<u>20,768</u>	<u>33,985</u>
By place of listing:		
Listed in Hong Kong	8,327	11,118
Listed outside Hong Kong	8,768	6,582
	<u>17,095</u>	<u>17,700</u>
Unlisted	3,673	16,285
	<u>20,768</u>	<u>33,985</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***14 Financial assets designated at fair value**

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Debt securities	1,575	2,154
Issued by:		
Corporate entities	1,575	2,154
By place of listing:		
Listed outside Hong Kong	1,239	1,389
Unlisted	336	765
	1,575	2,154

The above financial assets designated at fair value represent certain debt securities with embedded derivatives that are not separately recognised.

15 Advances to customers**(a) Advances to customers**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross advances to customers	453,552	451,713	451,270	438,175
Trade bills	3,237	2,892	3,237	2,892
	456,789	454,605	454,507	441,067
Less : Impairment provision				
– individually assessed (note 16(a))	(1,440)	(382)	(1,437)	(373)
– collectively assessed (note 16(a))	(353)	(665)	(353)	(508)
	454,996	453,558	452,717	440,186

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***15 Advances to customers (continued)****(b) Impaired advances to customers**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross impaired advances to customers	2,712	1,935	2,570	1,842
Impairment provision – individually assessed	(1,440)	(382)	(1,437)	(373)
	<u>1,272</u>	<u>1,553</u>	<u>1,133</u>	<u>1,469</u>
Gross impaired advances to customers as a % of gross advances to customers	<u>0.59%</u>	<u>0.43%</u>	<u>0.57%</u>	<u>0.42%</u>
Fair value of collateral held against the covered portion of impaired advances to customers	<u>1,206</u>	<u>1,150</u>	<u>1,206</u>	<u>1,131</u>
Covered portion of impaired advances to customers	725	567	725	559
Uncovered portion of impaired advances to customers	<u>1,987</u>	<u>1,368</u>	<u>1,845</u>	<u>1,283</u>

The covered portion of impaired advances to customers represents the amount of collateral held against outstanding balances. It does not include any collateral held over and above outstanding exposures.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***15 Advances to customers (continued)****(c) Net investment in finance leases**

Advances to customers include the net investment in equipment leased to customers under finance leases. The total minimum lease payments receivable under finance leases and their present values at the year end, are as follows:

Consolidated

	2014			2013		
	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Within 1 year	–	–	–	5	–	5
After 1 year but within 5 years	–	–	–	–	–	–
After 5 years	–	–	–	–	–	–
	<u>–</u>	<u>–</u>	<u>–</u>	<u>5</u>	<u>–</u>	<u>5</u>
Impairment provision:						
– individually assessed	<u>–</u>			<u>–</u>		
Net investment in finance leases	<u>–</u>			<u>5</u>		

Bank

The Bank has no net investment in finance lease (2013: Nil).

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***16 Movement in impairment provision on advances to banks and customers****(a) Advances to customers****Consolidated**

	<i>Individually assessed HK\$'M</i>	<i>2014 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2014	382	665	1,047
Amounts written off	(1,400)	–	(1,400)
Recoveries of advances written off in previous years	242	–	242
Net charge to the income statement (note 6(a))	2,270	(151)	2,119
Unwind of discount on loan impairment provision (note 4(a))	(36)	–	(36)
Transfer to asset held for sale	(18)	(161)	(179)
	<u>1,440</u>	<u>353</u>	<u>1,793</u>
At 31 December 2014 (note 15(a))	<u>1,440</u>	<u>353</u>	<u>1,793</u>
		<i>2013</i>	
	<i>Individually assessed HK\$'M</i>	<i>Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2013	494	567	1,061
Amounts written off	(1,253)	–	(1,253)
Recoveries of advances written off in previous years	240	–	240
Net charge to the income statement (note 6(a))	921	98	1,019
Unwind of discount on loan impairment provision (note 4(a))	(20)	–	(20)
	<u>382</u>	<u>665</u>	<u>1,047</u>
At 31 December 2013 (note 15(a))	<u>382</u>	<u>665</u>	<u>1,047</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***16 Movement in impairment provision on advances to banks and customers (continued)****(a) Advances to customers (continued)****Bank**

	<i>Individually assessed HK\$'M</i>	<i>2014 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2014	373	508	881
Amounts written off	(877)	–	(877)
Recoveries of advances written off in previous years	187	–	187
Net charge to the income statement	1,785	(155)	1,630
Unwind of discount on loan impairment provision	(31)	–	(31)
	<u>1,437</u>	<u>353</u>	<u>1,790</u>
At 31 December 2014 (note 15(a))	<u>1,437</u>	<u>353</u>	<u>1,790</u>

	<i>Individually assessed HK\$'M</i>	<i>2013 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2013	489	454	943
Amounts written off	(849)	–	(849)
Recoveries of advances written off in previous years	198	–	198
Net charge to the income statement	554	54	608
Unwind of discount on loan impairment provision	(19)	–	(19)
	<u>373</u>	<u>508</u>	<u>881</u>
At 31 December 2013 (note 15(a))	<u>373</u>	<u>508</u>	<u>881</u>

(b) Placements with banks and other financial institutions**Consolidated and Bank**

	<i>Individually assessed 2014 HK\$'M</i>	<i>2013 HK\$'M</i>
At 1 January	–	1
Charge to the income statement (note 6(a))	22	–
Unwind of discount on loan impairment provision (note 4(a))	–	(1)
Amounts written off	(22)	–
	<u>–</u>	<u>–</u>
At 31 December (note 11(a))	<u>–</u>	<u>–</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***17 Investment securities**

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Available-for-sale securities		
Treasury bills	53,424	66,152
Certificates of deposit held	15,086	34,737
Debt securities	94,505	91,640
Equity shares	468	450
Less: impairment provision	(15)	(15)
	<u>163,468</u>	<u>192,964</u>
	-----	-----
Loans and receivables – Debt securities	8,834	6,217
	<u>172,302</u>	<u>199,181</u>
	=====	=====
Issued by:		
Available-for-sale securities		
Central governments and central banks	84,229	87,007
Public sector entities	2,802	2,639
Banks and other financial institutions	49,707	84,446
Corporate entities	26,730	18,872
	<u>163,468</u>	<u>192,964</u>
	-----	-----
Loans and receivables – Debt securities		
Corporate entities	8,834	6,217
	<u>172,302</u>	<u>199,181</u>
	=====	=====

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***17 Investment securities (continued)**

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
By place of listing:		
Available-for-sale securities		
Listed in Hong Kong	15,155	12,859
Listed outside Hong Kong	64,540	64,334
	<u>79,695</u>	<u>77,193</u>
Unlisted	83,773	115,771
	<u>163,468</u>	<u>192,964</u>
	-----	-----
Loans and receivables – Debt securities		
Listed outside Hong Kong	2,489	1,520
Unlisted	6,345	4,697
	<u>8,834</u>	<u>6,217</u>
	-----	-----
	<u>172,302</u>	<u>199,181</u>
	=====	=====

18 Amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank

During the year, the Bank and its subsidiaries entered into transactions with related parties in the ordinary course of its banking business including lending, acceptance and placement of inter-bank deposits, correspondent banking transactions, banking operation/outsourcing activities and off-balance sheet transactions.

The Bank has entered into various risk participation transactions with related companies. For funded risk participation transactions, the Bank undertakes to deposit an amount equal to the participating balances with the related companies. When there is a default, under the undertaking clause of the agreement, the Bank is obligated to honor the risk participation by transferring such deposits to the related companies.

During the year, none of these deposits (2013: Nil) were transferred to the related companies. As at 31 December 2014, the amount due from group companies shown on the balance sheet is stated net of HK\$1,554 million (2013: HK\$1,570 million) in respect of such obligations.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***18 Amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank (continued)****Consolidated**

The amounts of material transactions during the year are set out below:

	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>	
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Operating income	2,632	322	728	649
Operating expenses	1,917	1,562	560	520

Material transactions entered during the year between the Bank and its subsidiaries included operating income of HK\$1,910 million (2013: HK\$1,934 million) and operating expense of HK\$81 million (2013: HK\$60 million). Intra-group transactions are eliminated in full in the consolidated income statement.

The amounts due from/to immediate holding company and fellow subsidiaries stated on the consolidated balance sheet included the following:

	<i>2014</i>		<i>2013</i>	
	<i>Immediate holding company</i>	<i>Fellow subsidiaries</i>	<i>Immediate holding company</i>	<i>Fellow subsidiaries</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Amounts due from:				
Cash and balances with banks and other financial institutions	8,170	5,028	3,639	4,770
Placements with banks and other financial institutions	53,852	35,891	37,100	29,287
Trading assets				
– Positive fair values of trading derivatives	4,817	1	10,515	43
Investment securities				
– Listed available-for-sale debt securities	–	4,509	–	498
Other assets				
– Positive fair values of hedging derivatives	833	103	718	–
– Others	2,591	529	1,717	582
	<u>70,263</u>	<u>46,061</u>	<u>53,689</u>	<u>35,180</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***18 Amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank (continued)****Consolidated (continued)**

	2014		2013	
	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M
Amounts due to:				
Deposits and balances of banks and other financial institutions	6,200	1,634	4,201	1,935
Deposits from customers	–	389	–	63
Trading liabilities:				
– Negative fair values of trading derivatives	5,580	1	10,631	44
Debt securities in issue	–	1,296	–	1,216
Other liabilities				
– Negative fair values of hedging derivatives	1,196	–	948	96
– Others	4,233	324	3,233	498
	<u>17,209</u>	<u>3,644</u>	<u>19,013</u>	<u>3,852</u>

The contractual amounts of contingent liabilities and commitments to the immediate holding company and fellow subsidiaries are set out below:

	2014		2013	
	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M
Financial guarantees and other credit related contingent liabilities	2,740	135	2,832	230
Loan commitments and other credit related commitments	<u>3,877</u>	<u>41,789</u>	<u>–</u>	<u>33,850</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***18 Amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank (continued)****Bank**

The amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank stated on the balance sheet included the following:

	2014			2013		
	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Subsidiaries of the Bank</i> HK\$'M	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Subsidiaries of the Bank</i> HK\$'M
Amounts due from:						
Cash and balances with banks and other financial institutions	7,583	4,823	–	2,684	4,603	–
Placements with banks and other financial institutions	53,852	35,891	47,269	36,945	29,282	8,662
Trading assets						
– Positive fair values of trading derivatives	4,815	1	–	10,511	43	–
Investment securities						
– Listed available-for-sale debt securities	–	4,509	–	–	498	–
Advances to customers	–	–	–	–	–	26,948
Other assets						
– Positive fair values of hedging derivatives	833	103	–	718	–	–
– Others	1,597	458	2,631	1,637	480	1,797
	<u>68,680</u>	<u>45,785</u>	<u>49,900</u>	<u>52,495</u>	<u>34,906</u>	<u>37,407</u>
Amounts due to:						
Deposits and balances of banks and other financial institutions	6,200	1,634	520	4,201	1,935	127
Deposits from customers	–	389	918	–	63	722
Trading liabilities:						
– Negative fair values of trading derivatives	5,580	1	–	10,631	44	–
Debt securities in issue	–	1,296	–	–	1,216	–
Other liabilities						
– Negative fair values of hedging derivatives	1,196	–	–	948	96	–
– Others	3,613	260	1,020	2,663	408	1,087
	<u>16,589</u>	<u>3,580</u>	<u>2,458</u>	<u>18,443</u>	<u>3,762</u>	<u>1,936</u>

The contractual amounts of contingent liabilities and commitments to the immediate holding company, fellow subsidiaries and subsidiaries of the Bank are set out below:

	2014			2013		
	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Subsidiaries of the Bank</i> HK\$'M	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Subsidiaries of the Bank</i> HK\$'M
Financial guarantees and other credit related contingent liabilities	2,740	135	4	2,832	230	8
Loan commitments and other credit related commitments	3,877	41,789	18,883	–	33,850	16,670

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***19 Investments in subsidiaries of the Bank**

	<i>Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Unlisted shares, at cost less impairment provision, if any	853	1,222

The following list contains only the particulars of subsidiaries which principally affected the results, assets or liabilities of the Bank and its subsidiaries.

<i>Name of company</i>	<i>Place of incorporation</i>	<i>Particulars of issued and paid up capital</i>	<i>Proportion of ownership interest held by the Bank</i>	<i>Principal activity</i>
Standard Chartered APR Limited	United Kingdom	21,971,715 ordinary shares of US\$1 each	100%	Investment holdings
Standard Chartered Securities (Hong Kong) Limited	Hong Kong	1,000,000 ordinary shares of HK\$10 each	100%	Equity capital markets, corporate finance and institutional brokerage
Standard Chartered Leasing Group Limited	Hong Kong	30,000 ordinary shares of US\$1 each	100%	Provision of leasing services

20 Interest in associates***Consolidated***

	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Share of net assets	8,376	7,079
Goodwill	1,717	1,717
Less: Impairment provision	(1,085)	(465)
	<u>9,008</u>	<u>8,331</u>

Bank

	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Unlisted investments, at cost less impairment losses, if any	3,168	3,290
Listed investment, at cost less impairment losses, if any	561	837
	<u>3,729</u>	<u>4,127</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***20 Interest in associates (continued)**

The following list contains only the particulars of material associates:

<i>Name of associate</i>	<i>Place of establishment and operation</i>	<i>Particulars of issued and paid up capital</i>	<i>Proportion of ownership interest</i>	<i>Principal activity</i>
Asia Commercial Joint Stock Bank ("ACB")	Vietnam	937,696,506 ordinary shares of VND10,000 each	15%	Provision of banking and related financial services (Note 1)
China Bohai Bank Company Limited ("Bohai")	The People's Republic of China	13,855,000,000 ordinary shares of RMB1 each	19.99%	Provision of banking and related financial services (Note 2)

Note 1: ACB is a strategic partner for the Group, providing investment opportunities and access to the Vietnam market.

Note 2: Bohai is a strategic partner for the Group to develop its China business.

Shareholdings in associated companies include a listed investment of HK\$1,351 million (2013: HK\$1,998 million). At the balance sheet date, the investment based on quoted market prices was valued at HK\$785 million (2013: HK\$807 million). Impairment testing on the investment has been carried out using a value-in-use methodology and this demonstrates that the recoverable amount of the investment was HK\$1,351 million and an additional impairment charge of HK\$620 million was recorded in 2014.

The Bank and its subsidiaries' investments in ACB and Bohai are less than 20% but both companies are considered to be associates because of the significant influence the Bank is able to exercise over the management of these companies and their financial and operating policies. Significant influence is evidenced largely through the interchange of management personnel and the provision of expertise.

In respect of the year ended 31 December 2014, the share of the results of ACB was included in these financial statements based on accounts drawn up to 30 September 2014, but taking into account any events or transactions in the subsequent period from 1 October 2014 to 31 December 2014 that would materially affect the results. Bohai's result was included in the financial statements based on accounts drawn up to 30 November 2014. The Bank and its subsidiaries have taken advantage of the provision contained in HKAS 28/IAS 28 "Investments in Associates" whereby it is permitted to include the attributable share of associates' results based on accounts drawn up to a non-coterminous period and where the difference is not greater than three months.

All of the above associates are accounted for using the equity method in the consolidated financial statements.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***20 Interest in associates (continued)****Summary of financial information of the material associates and reconciliation to the carrying amounts in the consolidated financial statements**

	2014		2013	
	ACB HK\$'M	Bohai HK\$'M	restated ACB HK\$'M	Bohai HK\$'M
Gross amounts of the associates				
Assets	64,979	826,655	58,990	686,025
Liabilities	(60,447)	(788,351)	(54,280)	(655,018)
Net assets	4,532	38,304	4,710	31,007
Operating income	2,003	19,413	2,031	15,411
Profit after taxation	198	6,863	300	5,677
Other comprehensive income/(loss)	–	597	–	(271)
Total comprehensive income	198	7,460	300	5,406
Dividends received from the associate	36	–	35	–
Gross amount of net assets of the associate	4,532	38,304	4,710	31,007
Effective interest of the Bank and its subsidiaries	15%	19.99%	15%	19.99%
Share of net assets of the associate attributable to the Bank and its subsidiaries	680	7,657	707	6,198
Fair value adjustment on acquisition	39	–	39	–
Goodwill	1,717	–	1,717	–
Less: Impairment provision	(1,085)	–	(465)	–
Carrying amount in the consolidated financial statements	1,351	7,657	1,998	6,198

Associates that are not individually material

	2014 HK\$'M	2013 HK\$'M
Carrying amount in the consolidated financial statements:		
– Interest in associates	–	135
– Assets held for sale (note 44)	144	–
Profit after taxation and total comprehensive income	10	8

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***20 Interest in associates (continued)****Reconciliation to the Bank and its subsidiaries' total interest in associates:**

	2014 HK\$'M	2013 HK\$'M
Carrying amount of material associates		
- ACB	1,351	1,998
- Bohai	7,657	6,198
Carrying amount of other associates	–	135
	<u>9,008</u>	<u>8,331</u>
Interest in associates in the consolidated financial statements	<u>9,008</u>	<u>8,331</u>

21 Fixed assets**Consolidated**

	2014					
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Operating lease assets HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost or valuation:						
At 1 January 2014	2,977	505	26,884	30,366	638	31,004
Additions	88	61	15,246	15,395	–	15,395
Transferred to asset classified as						
asset held for sale	(53)	(7)	–	(60)	(10)	(70)
Disposals and write-offs	(56)	(76)	(3,014)	(3,146)	–	(3,146)
Reclassifications	(35)	35	–	–	–	–
Fair value adjustments (note 4(f))	–	–	–	–	306	306
	<u>2,921</u>	<u>518</u>	<u>39,116</u>	<u>42,555</u>	<u>934</u>	<u>43,489</u>
At 31 December 2014	2,921	518	39,116	42,555	934	43,489
Representing:						
Cost	2,921	518	39,116	42,555	–	42,555
Valuation	–	–	–	–	934	934
	<u>2,921</u>	<u>518</u>	<u>39,116</u>	<u>42,555</u>	<u>934</u>	<u>43,489</u>
Accumulated depreciation:						
At 1 January 2014	676	238	1,517	2,431	–	2,431
Charge for the period (note 4(g))	111	97	1,214	1,422	–	1,422
Transferred to asset classified as						
asset held for sale	(10)	(4)	–	(14)	–	(14)
Attributable to assets sold or written off	(56)	(76)	(168)	(300)	–	(300)
	<u>721</u>	<u>255</u>	<u>2,563</u>	<u>3,539</u>	<u>–</u>	<u>3,539</u>
At 31 December 2014	721	255	2,563	3,539	–	3,539
Net book value:						
At 31 December 2014	<u>2,200</u>	<u>263</u>	<u>36,553</u>	<u>39,016</u>	<u>934</u>	<u>39,950</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Fixed assets (continued)****Consolidated (continued)**

	2013					
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Operating lease assets HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost or valuation:						
At 1 January 2013	2,946	513	21,202	24,661	511	25,172
Additions	100	115	6,783	6,998	–	6,998
Disposals and write-offs	(29)	(163)	(1,101)	(1,293)	–	(1,293)
Reclassifications	(40)	40	–	–	–	–
Fair value adjustments (note 4(f))	–	–	–	–	127	127
At 31 December 2013	2,977	505	26,884	30,366	638	31,004
Representing:						
Cost	2,977	505	26,884	30,366	–	30,366
Valuation	–	–	–	–	638	638
	2,977	505	26,884	30,366	638	31,004
Accumulated depreciation:						
At 1 January 2013	591	269	607	1,467	–	1,467
Charge for the year (note 4(g))	114	132	1,005	1,251	–	1,251
Attributable to assets sold or written off	(29)	(163)	(95)	(287)	–	(287)
At 31 December 2013	676	238	1,517	2,431	–	2,431
Net book value:						
At 31 December 2013	2,301	267	25,367	27,935	638	28,573

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Fixed assets (continued)****Bank**

	2014				
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost or valuation:					
At 1 January 2014	2,726	427	3,153	628	3,781
Additions	86	58	144	–	144
Disposals and write-offs	(56)	(75)	(131)	–	(131)
Reclassifications	(32)	32	–	–	–
Fair value adjustments	–	–	–	306	306
	<u>2,724</u>	<u>442</u>	<u>3,166</u>	<u>934</u>	<u>4,100</u>
At 31 December 2014	2,724	442	3,166	934	4,100
Representing:					
Cost	2,724	442	3,166	–	3,166
Valuation	–	–	–	934	934
	<u>2,724</u>	<u>442</u>	<u>3,166</u>	<u>934</u>	<u>4,100</u>
Accumulated depreciation:					
At 1 January 2014	659	219	878	–	878
Charge for the period	104	86	190	–	190
Attributable to assets sold or written off	(56)	(75)	(131)	–	(131)
	<u>707</u>	<u>230</u>	<u>937</u>	<u>–</u>	<u>937</u>
At 31 December 2014	707	230	937	–	937
Net book value:					
At 31 December 2014	<u>2,017</u>	<u>212</u>	<u>2,229</u>	<u>934</u>	<u>3,163</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Fixed assets (continued)****Bank (continued)**

	2013				
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost or valuation:					
At 1 January 2013	2,699	465	3,164	503	3,667
Additions	95	82	177	–	177
Disposals and write-offs	(29)	(159)	(188)	–	(188)
Reclassifications	(39)	39	–	–	–
Fair value adjustments	–	–	–	125	125
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
At 31 December 2013	2,726	427	3,153	628	3,781
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Representing:					
Cost	2,726	427	3,153	–	3,153
Valuation	–	–	–	628	628
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	<u>2,726</u>	<u>427</u>	<u>3,153</u>	<u>628</u>	<u>3,781</u>
Accumulated depreciation:					
At 1 January 2013	579	258	837	–	837
Charge for the year	109	120	229	–	229
Attributable to assets sold or written off	(29)	(159)	(188)	–	(188)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
At 31 December 2013	659	219	878	–	878
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Net book value:					
At 31 December 2013	<u>2,067</u>	<u>208</u>	<u>2,275</u>	<u>628</u>	<u>2,903</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Fixed assets (continued)****(a) Buildings and leasehold land held for own use**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Leasehold in Hong Kong, at cost				
– long-term leases	–	35	–	–
– medium-term leases	1,935	1,982	1,935	1,970
– short-term leases	82	97	82	97
	<u>2,017</u>	<u>2,114</u>	<u>2,017</u>	<u>2,067</u>
Freehold outside Hong Kong, at cost	<u>183</u>	<u>187</u>	<u>–</u>	<u>–</u>
	<u><u>2,200</u></u>	<u><u>2,301</u></u>	<u><u>2,017</u></u>	<u><u>2,067</u></u>

(b) Investment properties

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Leasehold in Hong Kong, at fair value				
– medium-term lease	–	10	–	–
Freehold outside Hong Kong, at fair value	<u>934</u>	<u>628</u>	<u>934</u>	<u>628</u>
	<u><u>934</u></u>	<u><u>638</u></u>	<u><u>934</u></u>	<u><u>628</u></u>

The investment property outside Hong Kong was revalued as at 31 December 2014 on an open market value basis. The valuation was carried out by an independent firm, CBRE Limited, which has among its staff, members of the Royal Institute of Chartered Surveyors with recent experience in the location and category of the property being valued.

The fair value of the investment property is primarily determined using comparable recent market transactions on arm's length terms.

These fair values are categorised as level 2 valuations using observable inputs.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Fixed assets (continued)****(c) Operating lease assets:**

Assets leased to customers under operating leases consist of commercial aircraft and vessels. At 31 December, the total future minimum lease receivables under operating leases are as follows:

	<i>Consolidated</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Within 1 year	3,664	2,606
After 1 year but within 5 years	11,855	7,661
After 5 years	15,850	12,031
	<u>31,369</u>	<u>22,298</u>

22 Goodwill and intangible assets***Consolidated***

	<i>2014</i>		
	<i>Capitalised software and other intangible assets</i>	<i>Goodwill</i>	<i>Total</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Cost:			
At 1 January 2014	702	1,507	2,209
Additions	111	–	111
Transferred to as asset held for sale	(14)	(525)	(539)
Disposals and write-offs	(131)	(253)	(384)
	<u>668</u>	<u>729</u>	<u>1,397</u>
At 31 December 2014	668	729	1,397
Accumulated amortisation:			
At 1 January 2014	276	–	276
Charge for the year (note 4(g))	112	–	112
Transferred to asset held for sale	(14)	–	(14)
Attributable to intangible assets sold or written off	(93)	–	(93)
	<u>281</u>	<u>–</u>	<u>281</u>
At 31 December 2014	281	–	281
Carrying amount:			
At 31 December 2014	<u>387</u>	<u>729</u>	<u>1,116</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***22 Goodwill and intangible assets (continued)**

	2013		
	<i>Capitalised software and other intangible assets</i> HK\$'M	<i>Goodwill</i> HK\$'M	<i>Total</i> HK\$'M
Cost:			
At 1 January 2013	481	1,507	1,988
Additions	253	–	253
Disposals and write-offs	(32)	–	(32)
	<hr/>	<hr/>	<hr/>
At 31 December 2013	702	1,507	2,209
	<hr/>	<hr/>	<hr/>
Accumulated amortisation:			
At 1 January 2013	167	–	167
Charge for the year (note 4(g))	141	–	141
Attributable to intangible assets sold or written off	(32)	–	(32)
	<hr/>	<hr/>	<hr/>
At 31 December 2013	276	–	276
	<hr/>	<hr/>	<hr/>
Carrying amount:			
At 31 December 2013	426	1,507	1,933
	<hr/>	<hr/>	<hr/>
Bank			
	2014		
	<i>Capitalised software and other intangible assets</i> HK\$'M	<i>Goodwill</i> HK\$'M	<i>Total</i> HK\$'M
Cost:			
At 1 January 2014	619	729	1,348
Additions	111	–	111
Disposals and write-offs	(62)	–	(62)
	<hr/>	<hr/>	<hr/>
At 31 December 2014	668	729	1,397
	<hr/>	<hr/>	<hr/>
Accumulated amortisation:			
At 1 January 2014	218	–	218
Charge for the year	106	–	106
Attributable to intangible assets sold or written off	(43)	–	(43)
	<hr/>	<hr/>	<hr/>
At 31 December 2014	281	–	281
	<hr/>	<hr/>	<hr/>
Carrying amount:			
At 31 December 2014	387	729	1,116
	<hr/>	<hr/>	<hr/>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***22 Goodwill and intangible assets (continued)**

	2013		
	<i>Capitalised software and other intangible assets</i> HK\$'M	<i>Goodwill</i> HK\$'M	<i>Total</i> HK\$'M
Cost:			
At 1 January 2013	398	729	1,127
Additions	253	–	253
Disposals and write-offs	(32)	–	(32)
	<hr/>	<hr/>	<hr/>
At 31 December 2013	619	729	1,348
	<hr/>	<hr/>	<hr/>
Accumulated amortisation:			
At 1 January 2013	116	–	116
Charge for the year	134	–	134
Attributable to intangible assets sold or written off	(32)	–	(32)
	<hr/>	<hr/>	<hr/>
At 31 December 2013	218	–	218
	<hr/>	<hr/>	<hr/>
Carrying amount:			
At 31 December 2013	401	729	1,130
	<hr/>	<hr/>	<hr/>

Impairment tests for cash-generating units containing goodwill

Goodwill is allocated to the Bank and its subsidiaries' cash-generating units ("CGUs") as follows:

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i> HK\$'M	<i>2013</i> HK\$'M	<i>2014</i> HK\$'M	<i>2013</i> HK\$'M
Lending	611	611	611	611
Private Banking	118	118	118	118
Standard Chartered Securities (Hong Kong) Limited (note 1)	–	253	–	–
Prime Credit Limited (note 2)	–	525	–	–
	<hr/>	<hr/>	<hr/>	<hr/>
	729	1,507	729	729
	<hr/>	<hr/>	<hr/>	<hr/>

The recoverable amounts of the CGUs are determined based on value in use calculations. The key assumptions and approach to determining value in use calculations, as set out below, are solely used for the purpose of assessing impairment on acquired goodwill. These calculations use cash flow projections over a 20-year period based on budgets and forecasts approved by management. These budgets and forecasts cover periods of one year and are extrapolated forward using steady growth rates of 3.9 per cent (2013: 4.4 per cent).

In assessing impairment of goodwill, the Bank and its subsidiaries assumed growth at a steady rate in line with long-term forecast GDP growth. A discount rate of 15.1 per cent (2013: 15.2 per cent) was used.

(note 1) The amount was fully written off in 2014 in view of the closure of the institutional cash equities, equity research and equity capital markets business announced by the Group on 8 January 2015 as the Group continues to exit or reconfigure non-core and underperforming businesses.

(note 2) The amount was transferred to assets held for sale (see note 44)

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***23 Other assets**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i>	<i>Restated 2013</i>	<i>2014</i>	<i>Restated 2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Prepayments and accrued income	2,230	2,795	2,218	2,738
Sundry debtors	1,667	1,607	1,476	1,384
Acceptances and endorsements	2,843	5,591	2,843	5,591
Unsettled trades and others	4,432	5,163	2,502	3,442
Assets held for sale (note)	13,217	–	326	–
	<u>24,389</u>	<u>15,156</u>	<u>9,365</u>	<u>13,155</u>

(note) Assets held for sale include the disposal group which consists of Prime Credit Limited and Shenzhen Prime Credit Limited. The assets and liabilities of the disposal group is summarised in note 44.

24 Deposits from customers

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Current accounts	142,839	113,756	142,839	113,756
Savings accounts	410,954	393,863	410,954	393,863
Time, call and notice deposits	261,688	273,209	261,688	272,081
Deposits and balances of central banks	35,548	36,600	35,548	36,600
	<u>851,029</u>	<u>817,428</u>	<u>851,029</u>	<u>816,300</u>

25 Debt securities in issue

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Certificates of deposit, measured at amortised cost	<u>13,838</u>	<u>15,336</u>

26 Financial liabilities designated at fair value

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Structured bank and customer deposits	7,528	3,897
Debt securities issued	<u>7,387</u>	<u>1,826</u>
	<u>14,915</u>	<u>5,723</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***26 Financial liabilities designated at fair value (continued)**

The Bank designates certain financial liabilities at fair value where either the liabilities:

- have fixed rates of interest and interest rate swaps or other interest related derivatives have been transacted with the intention of significantly reducing interest rate risk; or
- are exposed to equity price risk, foreign currency risk or credit risk and derivatives have been transacted with the intention of significantly reducing exposure to market changes;

At 31 December 2014, the contractual amount payable at maturity of these financial liabilities exceeded the carrying amount by HK\$594 million (2013: HK\$60 million). Of this, the cumulative fair value movement relating to changes in credit risk was a gain of HK\$725 million (2013: HK\$2 million). The amount of fair value movement relating to changes in credit risk recognised in the income statement during the year was HK\$723 million (2013: HK\$2 million).

27 Taxation in the balance sheet***Deferred tax assets and liabilities:***

The components of gross deferred tax (assets)/liabilities recognised in the balance sheet and the movements during the year are as follows:

Consolidated

	<i>Depreciation allowances in excess of related depreciation HK\$'M</i>	<i>Impairment losses on financial assets HK\$'M</i>	<i>Available- for-sale securities HK\$'M</i>	<i>Others HK\$'M</i>	<i>Total HK\$'M</i>
<i>2014</i>					
<i>Deferred tax arising from:</i>					
At 1 January 2014	452	(110)	24	(529)	(163)
Charge/(release) to income statement (note 7(a))	235	25	–	(85)	175
Charge to reserves	–	–	13	19	32
Transfer to assets held for sale	1	26	–	–	27
	<u>688</u>	<u>(59)</u>	<u>37</u>	<u>(595)</u>	<u>71</u>
<i>2013</i>					
At 1 January 2013	221	(101)	40	(205)	(45)
Charge/(release) to income statement (note 7(a))	231	(16)	–	(351)	(136)
(Release)/charge to reserves	–	–	(16)	25	9
Disposal of a subsidiary	–	7	–	2	9
	<u>452</u>	<u>(110)</u>	<u>24</u>	<u>(529)</u>	<u>(163)</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

27 Taxation in the balance sheet (continued)

Deferred tax assets and liabilities (continued):

The components of gross deferred tax (assets)/liabilities recognised in the balance sheet and the movements during the year are as follows (continued):

Bank

	<i>Depreciation allowances in excess of related depreciation</i> HK\$'M	<i>Impairment losses on financial assets</i> HK\$'M	<i>Available-for-sale securities</i> HK\$'M	<i>Others</i> HK\$'M	<i>Total</i> HK\$'M
2014					
Deferred tax arising from:					
At 1 January 2014	58	(84)	24	(225)	(227)
Charge to income statement	7	25	–	41	73
Charge to reserves	–	–	13	19	32
At 31 December 2014	<u>65</u>	<u>(59)</u>	<u>37</u>	<u>(165)</u>	<u>(122)</u>
2013					
At 1 January 2013	29	(75)	40	(32)	(38)
Charge/(release) to income statement	29	(9)	–	(218)	(198)
(Release)/Charge to reserves	–	–	(16)	25	9
At 31 December 2013	<u>58</u>	<u>(84)</u>	<u>24</u>	<u>(225)</u>	<u>(227)</u>
	<i>Consolidated</i>		<i>Bank</i>		
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>	
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	
Analysed by:					
Net deferred tax asset recognised on the balance sheet	(141)	(275)	(122)	(227)	
Net deferred tax liability recognised on the balance sheet	<u>212</u>	<u>112</u>	<u>–</u>	<u>–</u>	
	<u>71</u>	<u>(163)</u>	<u>(122)</u>	<u>(227)</u>	

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***28 Trading liabilities**

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Short positions in securities	11,995	22,417
Negative fair values of trading derivatives	805	1,130
	<u>12,800</u>	<u>23,547</u>

29 Other liabilities

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Accruals and deferred income	4,009	4,525	3,715	4,121
Provision for liabilities and charges	311	129	123	62
Acceptances and endorsements	2,843	5,591	2,843	5,591
Unsettled trades and others	10,417	11,802	9,529	11,019
Liabilities held for sale (note)	2,002	–	–	–
	<u>19,582</u>	<u>22,047</u>	<u>16,210</u>	<u>20,793</u>

(note) Liabilities held for sale include the disposal group which consists of Prime Credit Limited and Shenzhen Prime Credit Limited. The assets and liabilities of the disposal group is summarised in note 44.

30 Employee retirement benefits

The Bank makes contributions to a defined benefit retirement scheme, namely Standard Chartered Bank Hong Kong Retirement Scheme (“the Scheme”), which provides lump sum benefits based on a multiple of a member’s final salary and years of service upon the member’s retirement, death, disability or leaving service. The Scheme is closed to new employees.

The Scheme was established under a trust arrangement. It is registered under the Occupational Retirement Schemes Ordinance (“ORSO”). The Bank is the sole employer participating in the Scheme.

The Bank has an unconditional right to the Scheme’s surplus and the Scheme has no minimum funding requirements.

The key responsibilities of the Scheme’s trustees are to ensure that the Scheme is administered in accordance with the trust deed and to act on behalf of all members impartially, prudently and in good faith.

The Scheme exposes the Bank to interest rate risk, investment risk and salary risk.

The Bank’s contributions are determined with reference to the funding valuation carried out by the Scheme’s actuary in accordance with the ORSO requirements. The last funding valuation of the Scheme was carried out as at 31 December 2014.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***30 Employee retirement benefits (continued)****(a) Amounts recognised in the consolidated balance sheet**

	2014 HK\$'M	2013 HK\$'M
Fair value of plan assets	2,173	2,203
Present value of wholly or partly funded obligations	(2,229)	(2,225)
Net liability recognised in the balance sheet (included in "Other liabilities")	<u>(56)</u>	<u>(22)</u>

(b) Movements in the fair value of plan assets and the present value of the defined benefit obligations

	2014		
	Assets HK\$'M	Obligations HK\$'M	Total HK\$'M
At 1 January 2014	2,203	(2,225)	(22)
Contributions	58	–	58
Benefits paid	(188)	188	–
Current service cost	–	(101)	(101)
Net interest income/(cost)	43	(42)	1
Administrative expenses	(1)	–	(1)
Return on plan assets, excluding amounts included in interest income	58	–	58
Actuarial loss – from experience	–	(11)	(11)
Actuarial loss – from financial assumptions	–	(38)	(38)
At 31 December 2014	<u>2,173</u>	<u>(2,229)</u>	<u>(56)</u>
	2013		
	Assets HK\$'M	Obligations HK\$'M	Total HK\$'M
At 1 January 2013	2,069	(2,309)	(240)
Contributions	62	–	62
Benefits paid	(152)	152	–
Current service cost	–	(109)	(109)
Net interest income/(cost)	14	(15)	(1)
Administrative expenses	(1)	–	(1)
Return on plan assets, excluding amounts included in interest income	211	–	211
Actuarial loss – from experience	–	(60)	(60)
Actuarial gain – from financial assumptions	–	116	116
At 31 December 2013	<u>2,203</u>	<u>(2,225)</u>	<u>(22)</u>

The weighted average duration of the defined benefit obligation as at 31 December 2014 is 6 years (2013: 6 years).

The Bank expects to contribute approximately HK\$57 million to the Scheme in 2015.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***30 Employee retirement benefits (continued)****(c) Amounts recognised in the consolidated income statement for the year**

	2014 HK\$'M	2013 HK\$'M
Current service cost	101	109
Net interest (income)/cost	(1)	1
Administrative expenses	1	1
	<u>101</u>	<u>111</u>

(d) Principal actuarial assumptions used in the valuation and sensitivity analysis

	2014 HK\$'M	2013 HK\$'M
Discount rate	1.70%	2.00%
Future salary increases	4.00%	4.00%

These assumptions are likely to change in the future and thus will affect the value placed on the defined benefit obligations. Changes at the reporting date to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation by the amounts shown below:

- if the discount rate increased by 25 basis points the obligation would reduce by approximately HK\$32 million (2013: HK\$32 million).
- if the rate of growth of salaries was higher by 25 basis points the obligation would increase by approximately HK\$30 million (2013: HK\$31 million).

The above sensitivity analysis is based on the assumption that changes in actuarial assumptions are not correlated and therefore it does not take into account the correlations between the actuarial assumptions.

(e) Major categories of assets

	2014 HK\$'M	2013 HK\$'M
Equities	59%	62%
Bonds	35%	31%
Cash	6%	7%
	<u>100%</u>	<u>100%</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***30 Employee retirement benefits (continued)****(e) Major categories of assets (continued)**

As at 31 December 2014, the Scheme did not invest in the Bank's own financial instruments and properties (2013: Nil). The Scheme has a benchmark asset allocation of 60% in equities and 40% in bonds and cash (2013: 60% in equities and 40% in bonds and cash). The long term strategic asset allocations of the Scheme are set and reviewed from time to time by the trustees taking into account the Scheme's membership, liability profile, liquidity requirements, and the risk appetite of the Bank.

31 Subordinated liabilities

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
US\$750 million 5.875% Fixed Rate Notes 2020 (note 1)	6,213	6,120
SGD750 million 4.15% Fixed Rate Notes 2021 (note 2)	4,193	4,428
	<u>10,406</u>	<u>10,548</u>

All subordinated liabilities are unsecured and subordinated to the claims of other creditors.

(note 1) Interest rate at 5.875 per cent per annum, payable semi-annually, to the maturity date on 24 June 2020.

(note 2) Interest rate at 4.15 per cent per annum, payable semi-annually, to the maturity date on 27 October 2021.

32 Share capital

	<i>2014</i>		<i>2013</i>	
	<i>No. of share</i>	<i>HK\$'M</i>	<i>No. of shares</i>	<i>HK\$'M</i>
Issued and fully paid				
A' ordinary shares	706 million	12,500	706 million	35
B' ordinary shares	1,231 million	78	1,231 million	62
US\$500 million 6.25% perpetual non-cumulative convertible preference shares	10	3,878	–	–
Fully repurchased in prior years				
HK\$3,800 million 8.25% non-cumulative preference shares	–	3,800	–	–
		<u>20,256</u>		<u>97</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

32 Share capital (continued)

The Hong Kong Companies Ordinance was revised with effect from 3 March 2014. Under the new Companies Ordinance (Cap. 622), amounts which were previously credited to the share premium account and capital redemption reserve have been aggregated together as part of the Bank's share capital. Since the share premium amounted to HK\$12,477 million was originated from class 'A' and class 'B' ordinary shares, and the capital redemption reserve amounted to HK\$3,804 million was originated from partial redemption of class 'A' ordinary shares and full redemption of preference shares in prior years, they were allocated back to the ordinary shares and preference share capital accordingly.

On 30 December 2014, 10 perpetual non-cumulative convertible preference shares were issued to Standard Chartered Bank at an aggregate issue price of US\$500 million with a liquidation preference of US\$500 million. Each preference share will be converted to 12,500,000 'A' Shares of US\$4.00 each upon a non-viability event as set out in the subscription agreement. The preference shares qualify as Additional Tier 1 capital under the Banking (Capital) Rules.

The convertible preference shares rank in priority to the 'A' ordinary shares and 'B' ordinary shares with respect to the payment of dividends and any return of capital. The 'B' ordinary shares rank in priority to the 'A' ordinary shares with respect to any return of capital.

33 Reserves

Nature and purpose of reserves

(i) Share premium and capital redemption reserve

Prior to 3 March 2014, the application of the share premium account and the capital redemption reserve was governed by sections 48B and 49H respectively of the former Hong Kong Companies Ordinance (Cap. 32). In accordance with the transitional provisions set out in section 37 of Schedule 11 to the new Hong Kong Companies Ordinance (Cap. 622), on 3 March 2014 any amount standing to the credit of the share premium account and the capital redemption reserve has become part of the Bank's share capital (see note 32). The use of share capital from 3 March 2014 is governed by the new Hong Kong Companies Ordinance (Cap. 622).

(ii) Available-for-sale investment reserve

The available-for-sale investment reserve comprises the cumulative net change in the fair value of available-for-sale securities held at the balance sheet date and is dealt with in accordance with the accounting policy in note 2(i).

(iii) Cash flow hedge reserve

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of hedging instruments used in cash flow hedges pending subsequent recognition of the hedged cash flow in accordance with the accounting policy adopted for cash flow hedges in note 2(j).

(iv) Exchange reserve

The exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations. The reserve is dealt with in accordance with the accounting policy set out in note 2(s).

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***33 Reserves (continued)*****Nature and purpose of reserves (continued)***

(v) Revaluation reserve

The revaluation reserve comprises the share of the change in fair value of an associate's identifiable net assets prior to the Bank and its subsidiaries obtaining significant influence in a step-acquisition.

(vi) Share option equity reserve

The Group operates equity-settled share-based compensation plans in which the Bank and its subsidiaries' employees participate. The fair value of the employee services received in exchange for the grant of the share awards is recognised as an expense with the corresponding amount credited to the share option equity reserve.

(vii) Property revaluation reserve

The property revaluation reserve represents the revaluation surplus arising upon the reclassification of a property previously included in "Buildings and leasehold land held for own use" to "investment properties".

The HKMA requires the Bank and its subsidiaries to maintain a minimum level of impairment allowances which is in excess of the impairment allowances required under Hong Kong Financial Reporting Standards. Of the retained earnings as at 31 December 2014, an amount of HK\$6,501 million (2013: HK\$6,148 million) has been reserved for this purpose.

34 Cash and cash equivalents

	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
(a) <i>Components of cash and cash equivalents in the cash flow statement</i>		
Cash and balances with banks, central banks and other financial institutions	53,076	26,885
Trading assets with original maturity within three months	2,501	5,807
Placements with banks and other financial institutions with original maturity within three months	81,149	66,343
Investment securities with original maturity within three months	35,325	20,720
Amounts due from immediate holding company and fellow subsidiaries with original maturity within three months	64,071	51,068
Add: Cash and balances with banks, central banks and other financial institutions included in "Assets held for sale"	125	–
Less: Overdrafts included in "deposits and balances of banks and other financial institutions"	–	(19)
Less: Overdrafts included in "amounts due to immediate holding company"	(3,397)	(1,997)
	<u>232,850</u>	<u>168,807</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Cash and cash equivalents (continued)**

	2014 HK\$'M	2013 HK\$'M
(b) Reconciliation with the consolidated balance sheet		
Cash and balances with banks, central banks, and other financial institutions	53,076	26,885
Trading assets	23,388	38,861
Placements with banks and other financial institutions	145,770	125,868
Investment securities	172,302	199,181
Amounts due from immediate holding company and fellow subsidiaries	116,324	88,869
Cash and balances with banks, central banks, and other financial institutions included in "Assets held for sale"	125	–
Overdrafts included in "deposits and balances of banks and other financial institutions"	–	(19)
Overdrafts included in "amounts due to immediate holding company"	(3,397)	(1,997)
	<u>507,588</u>	<u>477,648</u>
Less: amounts with an original maturity of beyond three months	(274,738)	(308,841)
	<u>232,850</u>	<u>168,807</u>
Cash and cash equivalents in the consolidated cash flow statement	<u>232,850</u>	<u>168,807</u>

35 Derivative financial instruments

The use of derivatives for trading and their sale to customers as risk management products is an integral part of the Bank's business activities. These instruments are also used to manage the Bank's own exposures to market risk as part of its asset and liability management process. The principal derivative instruments used by the Bank are foreign exchange related and interest rate related contracts, which are primarily over-the-counter derivatives. Most of the Bank's derivative positions have been entered into to meet customer demand and to hedge these and other trading positions. For accounting purposes, derivatives are classified as either held for trading or held for hedging.

(a) Notional amounts of derivatives

The notional amounts of these instruments indicate the volume of transactions outstanding and do not represent amounts at risk.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Derivative financial instruments (continued)****(a) Notional amounts of derivatives (continued)**

The following is a summary of the notional amounts of each significant type of derivative entered into by the Bank and its subsidiaries:

Consolidated

	2014			Total HK\$'M
	Qualifying for hedge accounting HK\$'M	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$'M	Others, including held for trading HK\$'M	
Exchange rate contracts				
Forwards	202	–	1,359,821	1,360,023
Cross currency swaps	26,365	3,282	19,331	48,978
Options purchased	–	289	402	691
Options written	–	19	4,187	4,206
Interest rate contracts				
Swaps	67,336	2,225	38,381	107,942
Options purchased	–	166	448	614
Options written	–	3,897	2,182	6,079
Other derivatives	–	4,172	5,821	9,993
	<u>93,903</u>	<u>14,050</u>	<u>1,430,573</u>	<u>1,538,526</u>
2013				
Exchange rate contracts				
Forwards	5,069	–	1,216,036	1,221,105
Cross currency swaps	15,259	200	32,109	47,568
Options purchased	–	52	6,436	6,488
Options written	–	246	6,878	7,124
Interest rate contracts				
Swaps	68,293	3,161	25,469	96,923
Options purchased	–	470	235	705
Options written	–	582	152	734
Other derivatives	–	1,078	2,556	3,634
	<u>88,621</u>	<u>5,789</u>	<u>1,289,871</u>	<u>1,384,281</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Derivative financial instruments (continued)**(a) Notional amounts of derivatives (continued)****Bank**

	2014			
	Qualifying for hedge accounting HK\$'M	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$'M	Others, including held for trading HK\$'M	Total HK\$'M
Exchange rate contracts				
Forwards	202	–	1,359,821	1,360,023
Cross currency swaps	26,365	3,282	19,331	48,978
Options purchased	–	289	402	691
Options written	–	19	4,187	4,206
Interest rate contracts				
Swaps	67,336	2,225	37,743	107,304
Options purchased	–	166	448	614
Options written	–	3,897	2,182	6,079
Other derivatives	–	4,172	5,821	9,993
	<u>93,903</u>	<u>14,050</u>	<u>1,429,935</u>	<u>1,537,888</u>
2013				
Exchange rate contracts				
Forwards	5,069	–	1,216,036	1,221,105
Cross currency swaps	15,259	200	32,109	47,568
Options purchased	–	52	6,436	6,488
Options written	–	246	6,878	7,124
Interest rate contracts				
Swaps	68,293	3,161	24,657	96,111
Options purchased	–	470	235	705
Options written	–	582	152	734
Other derivatives	–	1,078	2,556	3,634
	<u>88,621</u>	<u>5,789</u>	<u>1,289,059</u>	<u>1,383,469</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Derivative financial instruments (continued)****(b) Fair values and credit risk weighted amounts of derivatives****Consolidated**

	2014			2013		
	<i>Fair value assets</i>	<i>Fair value liabilities</i>	<i>Credit risk weighted amount</i>	<i>Fair value assets</i>	<i>Fair value liabilities</i>	<i>Credit risk weighted amount</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Exchange rate contracts	5,153	5,495	5,813	11,217	11,892	8,317
Interest rate contracts	1,430	1,889	7,347	871	721	850
Other derivatives	187	198	331	81	236	174
	<u>6,770</u>	<u>7,582</u>	<u>13,491</u>	<u>12,169</u>	<u>12,849</u>	<u>9,341</u>

Bank

	2014			2013		
	<i>Fair value assets</i>	<i>Fair value liabilities</i>	<i>Credit risk weighted amount</i>	<i>Fair value assets</i>	<i>Fair value liabilities</i>	<i>Credit risk weighted amount</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Exchange rate contracts	5,153	5,495	5,813	11,217	11,892	8,317
Interest rate contracts	1,428	1,889	7,325	867	721	833
Other derivatives	187	198	331	81	236	110
	<u>6,768</u>	<u>7,582</u>	<u>13,469</u>	<u>12,165</u>	<u>12,849</u>	<u>9,260</u>

Credit risk weighted amount refers to the amount as computed in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance. The amount calculated is dependent upon the status of the counterparty and maturity characteristics of each type of contract.

The fair values and credit risk weighted amounts do not take into account any bilateral netting arrangements entered into during the year and accordingly these amounts are shown on a gross basis.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Derivative financial instruments (continued)****(c) Fair value of derivative financial instruments designated as hedging instruments**

The following is a summary of the fair values of derivatives held for hedging purposes by product type entered into by the Bank and its subsidiaries:

Consolidated and Bank

	2014	
	Assets <i>(Included in Amounts due from immediate holding company and fellow subsidiaries)</i> HK\$'M	Liabilities <i>(Included in Amounts due to immediate holding company and fellow subsidiaries)</i> HK\$'M
Exchange rate contracts	444	307
Interest rate contracts	492	889
	936	1,196
	936	1,196
	2013	
	Assets <i>(Included in Other assets and Amounts due from immediate holding company and fellow subsidiaries)</i> HK\$'M	Liabilities <i>(Included in Amounts due to immediate holding company and fellow subsidiaries)</i> HK\$'M
Exchange rate contracts	6	544
Interest rate contracts	712	500
	718	1,044
	718	1,044

Fair value hedges

The fair value hedges principally consist of interest rate swaps and cross currency swaps. The interest rate swaps are used to protect against changes in the fair value of certain fixed rate assets and liabilities due to movements in market interest rates. The cross currency swaps are used to manage foreign exchange exposures. At 31 December 2014, the net negative fair value of derivatives held as fair value hedges was HK\$417 million (2013: positive HK\$42 million) comprising assets of HK\$752 million (2013: HK\$681 million) and liabilities of HK\$1,169 million (2013: HK\$639 million). The losses on the hedging instruments for the year were HK\$615 million (2013: gains of HK\$691 million). The gains on the hedged item attributable to the hedged risk were HK\$568 million (2013: losses of HK\$644 million).

Cash flow hedges

The cash flow hedges principally consist of interest rate swaps and cross currency swaps that are used to hedge against the variability in cash flows of certain floating rate assets and liabilities. At 31 December 2014, the net positive fair value of derivatives held as cash flow hedges was HK\$157 million (2013: negative HK\$368 million) comprising assets of HK\$184 million (2013: HK\$37 million) and liabilities of HK\$27 million (2013: HK\$405 million). During the year, there was no ineffectiveness recognised in the income statement that arose from cash flow hedges (2013: Nil).

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Derivative financial instruments (continued)****(c) Fair value of derivative financial instruments designated as hedging instruments (continued)**

The time periods in which the hedged cash flows are expected to occur and affect the consolidated statement of comprehensive income are as follows:

	<i>Less than 1 year HK\$'M</i>	<i>1 to 2 years HK\$'M</i>	<i>2 to 3 years HK\$'M</i>	<i>3 to 4 years HK\$'M</i>	<i>4 to 5 years HK\$'M</i>	<i>Total HK\$'M</i>
<i>2014</i>						
Forecast receivable cash flows	156	132	34	6	–	328
Forecast payable cash flows	(18)	(34)	(52)	(32)	(5)	(141)
	<u>138</u>	<u>98</u>	<u>(18)</u>	<u>(26)</u>	<u>(5)</u>	<u>187</u>
<i>2013</i>						
Forecast receivable cash flows	178	61	40	15	6	300
Forecast payable cash flows	(14)	(12)	(23)	(13)	(2)	(64)
	<u>164</u>	<u>49</u>	<u>17</u>	<u>2</u>	<u>4</u>	<u>236</u>

36 Contingent liabilities and commitments**(a) The following is a summary of the contractual amounts of each significant contingent liability and commitment:**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014 HK\$'M</i>	<i>2013 HK\$'M</i>	<i>2014 HK\$'M</i>	<i>2013 HK\$'M</i>
Direct credit substitutes	5,262	6,885	5,262	6,885
Transaction-related contingencies	5,519	9,316	5,523	9,320
Trade-related contingencies	17,265	23,735	17,265	23,740
Forward asset purchases	289	279	289	279
Forward forward deposits placed	3,877	388	3,877	388
Other commitments:				
which are not unconditionally cancellable:				
with original maturity of not more than one year	6,982	10,307	6,384	9,614
with original maturity of more than one year	17,822	24,294	17,822	24,295
which are unconditionally cancellable	391,520	394,614	409,455	410,480
	<u>448,536</u>	<u>469,818</u>	<u>465,877</u>	<u>485,001</u>
Credit risk weighted amount	<u>40,839</u>	<u>33,270</u>	<u>40,754</u>	<u>33,254</u>

Contingent liabilities and commitments are credit-related instruments, which include letters of credit, guarantees and commitments to extend credit. The risk involved is similar to the credit risk involved in extending loan facilities to customers. These transactions are, therefore, subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client defaults. As the facilities may expire without being drawn upon, the contracted amounts do not represent expected future cash flows.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***36 Contingent liabilities and commitments (continued)****(b) Capital commitments**

Capital commitments outstanding at 31 December in respect of fixed asset purchases not provided for in the financial statements were as follows:

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Contracted for	50	71
Authorised but not contracted for	55	2
	<u>105</u>	<u>73</u>

(c) Lease commitments

The Bank and its subsidiaries lease a number of properties under operating leases. The leases typically run for an initial period of two to ten years, with an option to renew the lease when all terms are renegotiated. At 31 December, total future minimum lease payments under non-cancellable operating leases are payable as follows:

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Within 1 year	821	871	821	847
After 1 year but within 5 years	1,727	1,888	1,727	1,878
After 5 years	1,067	1,341	1,067	1,341
	<u>3,615</u>	<u>4,100</u>	<u>3,615</u>	<u>4,066</u>

During the year, HK\$966 million (2013: HK\$861 million) was recognised as an expense in the income statement in respect of operating leases. The Bank and its subsidiaries lease various premises and equipment under non-cancellable operating lease agreements.

(d) Contingencies

The Bank and its subsidiaries receive legal claims against it arising in the normal course of business. The Bank and its subsidiaries consider none of these matters as material. Where appropriate the Bank and its subsidiaries recognise a provision for liabilities when it is probable that an outflow of economic resources embodying economic benefits will be required and for which a reliable estimate can be made of the obligation.

37 Risk management

The management of risk lies at the heart of the Bank's business. One of the principal risks the Bank incurs arises from extending credit to customers through its trading and lending operations. Beyond credit risk, the Bank is also exposed to a range of other risk types such as cross-border country, market, liquidity, operational, pensions, reputational and other risks that are inherent to the Bank's strategy, product range and business coverage.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)***Risk management framework***

Effective risk management is fundamental to being able to generate profits consistently and sustainably – and is thus a central part of the financial and operational management of the Bank.

Through its Risk Management Framework (“RMF”) the Bank manages enterprise-wide risks, with the objective of maximising risk-adjusted returns while remaining within its risk appetite.

As part of this framework, the Bank uses a set of principles that describe the risk management culture the Bank wishes to sustain:

Balancing risk and return

- a. We manage our risks to build a sustainable franchise, in the interests of all our stakeholders
- b. We only take risk within our risk tolerances and risk appetite, and where consistent with our approved strategy
- c. We manage our risk profile to maintain a low probability of an unexpected loss event that would materially undermine the confidence of our investors

Conduct of business

- d. We demonstrate we are Here for good through our conduct, and are mindful of the reputational consequences of inappropriate conduct
- e. We seek to achieve good outcomes for clients, investors, and the markets in which we operate, while abiding by the spirit and letter of laws and regulations
- f. We treat our colleagues fairly and with respect

Responsibility and Accountability

- g. We take individual responsibility to ensure risk-taking is disciplined and focused, particularly within our area of authority
- h. We make sure risk taking is transparent, controlled and reported in line with the risk management framework, within risk appetite and risk tolerance boundaries, and only where there is appropriate infrastructure and resource

Anticipation

- i. We seek to anticipate material future risks, learn lessons from events that have produced adverse outcomes and ensure awareness of known risks

Competitive advantage

- j. We seek to achieve competitive advantage through efficient and effective risk management and control

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk governance

Ultimate responsibility for setting our risk appetite and for the effective management of risk rests with the Board.

Acting within an authority delegated by the Board, the Board's Audit and Risk Committee ("BARC"), whose membership is comprised exclusively of non-executive directors, has responsibility for oversight and review of prudential risks including but not limited to credit, market, capital, liquidity and operational risks. It reviews the Bank's overall risk tolerance statement and makes recommendations thereon to the Board.

Acting within an authority delegated by the Board via the Executive Committee ("ExCo"), the Bank's Executive Risk Committee ("ERC") is responsible for the management of all risks other than those delegated to the Asset and Liability Committee ("ALCO") and the Country Pensions Committee ("CPC"). The ERC is responsible for the establishment of, and compliance with policies relating to credit risk, country cross-border risk, market risk, operational risk and reputational risk. The ERC also defines the overall risk management framework.

The ALCO is responsible for the management of capital and the establishment of, and compliance with, policies relating to balance sheet management, including management of our liquidity, capital adequacy and structural foreign exchange and interest rate risk. The CPC is responsible for the management of Pensions Risk.

The committee governance structure ensures that risk-taking authority and risk management policies are cascaded down from the Board through to the appropriate functional, divisional and country-level committees. Information regarding material risk issues and compliance with policies and standards is communicated to the business and functional committees.

Roles and responsibilities for risk management are defined under a 'three lines of defence' model. Each line of defence describes a specific set of responsibilities for risk management and control.

- First line of defence: all employees are required to ensure the effective management of risks within the scope of their direct organisational responsibilities. Business, function and geographic governance heads are accountable for risk management in their respective businesses and functions, and for countries where they have governance responsibilities.
- Second line of defence: this comprises the Risk Control Owners, supported by their respective control functions. Risk Control Owners are responsible for ensuring that the risks within the scope of their responsibilities remain within appetite. The scope of a Risk Control Owner's responsibilities is defined by a given Risk Type and the risk management processes that relate to that Risk Type. These responsibilities cut across the Bank and are not constrained by functional and business boundaries. The major risk types are described individually in the following sections.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk governance (continued)

- Third line of defence: the independent assurance provided by the Group Internal Audit (“GIA”) function. Its role is defined and overseen by the BARC.
 - The findings from GIA’s audits are reported to all relevant management and governance bodies, accountable line managers, relevant oversight function or committee and committees of the Board.
 - GIA provides independent assurance of the effectiveness of management’s control of its own business activities (the first line) and of the processes maintained by the Risk Control Functions (the second line). As a result, GIA provides assurance that the overall system of control effectiveness is working as required within the RMF.

The Risk function

The Country Chief Risk Officer (“CCRO”) directly manages a Risk function that is separate from and independent of the origination, trading and sales functions of the businesses. The CCRO chairs the ERC and is a member of ExCo.

The role of the Risk function is:

- To maintain the RMF, ensuring it remains appropriate to the Bank’s activities, is effectively communicated and implemented across the Bank and to administer related governance and reporting processes.
- To uphold the overall integrity of the Bank’s risk/return decisions, and in particular ensures that risks are properly assessed, that risk/return decisions are made transparently on the basis of this proper assessment, and are controlled in accordance with the Bank’s standards and risk appetite.
- To exercise direct Risk Control Ownership for Credit, Market, Country Cross-Border, Short-term Liquidity and Operational risk types.

Risk appetite

We manage our risks to build a sustainable franchise in the interests of all our stakeholders. Risk appetite is an expression of the amount of risk we are willing to take in pursuit of our strategic objectives, reflecting our capacity to sustain losses and continue to meet our obligations arising from a range of different stress trading conditions.

We define our risk appetite in terms of both volatility of earnings and the maintenance of adequate regulatory capital requirements under stress scenarios. We also define a risk appetite with respect to liquidity risk, operational risk and reputational risk.

Our quantitative risk profile is assessed through a bottom-up analytical approach covering all of our major businesses and products. It is also assessed against a range of exposure concentration thresholds. The Bank’s risk appetite statement is approved by the Board and forms the basis for establishing the risk parameters within which the businesses must operate, including policies, concentration limits and business mix.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)***Risk appetite (continued)***

The Bank will not compromise adherence to its risk appetite in order to pursue revenue growth or higher returns.

The ERC and ALCO are responsible for ensuring that our risk profile is managed in compliance with the risk appetite set by the Board.

Stress testing

Stress testing and scenario analysis are used to assess the financial and management capability of the Bank to continue operating effectively under extreme but plausible trading conditions.

Our stress testing framework is designed to:

- Contribute to the setting and monitoring of risk appetite
- Identify key risks to our strategy, financial position, and reputation
- Support the development of mitigating actions and contingency plans including business continuity
- Meet regulatory requirements.

Our stress testing activity focuses on the potential impact of market, macroeconomic, geopolitical and physical events on relevant geographies, customer segments and asset classes.

(a) Credit risk

Credit risk is the potential for loss due to the failure of a counterparty to meet its obligations to pay in accordance with agreed terms. Credit exposures may arise from both the banking and trading books.

Credit risk is managed through a framework that sets out policies and procedures covering the measurement and management of credit risk. There is a clear segregation of duties between transaction originators in the businesses and the approvers in the Risk function. All credit exposure limits are approved within a defined credit approval authority framework.

Group-wide credit policies and standards are considered and approved by the Group Risk Committee ("GRC"), which also oversees the delegation of credit approval and loan impairment provisioning authorities.

The ERC approves policies and standards based on those approved by GRC, risk limits and risk exposure delegated approval authority frameworks. When approving risk policies and standards, the ERC takes into account the requirements of the Hong Kong Banking Ordinance and the guidelines issued by the HKMA with respect to large exposures, connected lending and provisioning requirements.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(a) Credit risk (continued)

Credit rating and measurement

Risk measurement plays a central role, along with judgement and experience, in informing risk-taking and portfolio management decisions. It is a primary area for sustained investment and senior management attention.

Since 1 January 2008, the Bank has used the Advanced Internal Ratings-Based (AIRB) approach under the Basel II regulatory framework to calculate credit risk capital.

For AIRB portfolios, a standard alphanumeric credit risk-grading system is used in both Corporate & Institutional Clients, Commercial Clients and Retail Clients. The grading is based on the Group's internal estimate of probability of default over a one year horizon, with customers or portfolios assessed against a range of quantitative and qualitative factors. The numeric grades run from 1 to 14 and some of the grades are further sub-classified A, B or C. Lower credit grades are indicative of a lower likelihood of default. Credit grades 1A to 12C are assigned to performing customers or accounts, while credit grades 13 and 14 are assigned to non-performing or defaulted customers.

The Bank's credit grades in Corporate & Institutional Clients and Commercial Clients are not intended to replicate external credit grades, and ratings assigned by external ratings agencies are not used in determining the Bank's internal credit grades. Nonetheless, as the factors used to grade a borrower may be similar, a borrower rated poorly by an external rating agency is typically assigned a worse internal credit grade.

AIRB models cover a substantial majority of the Bank's loans and are used extensively in assessing risks at customer and portfolio level, setting strategy and optimising the Bank's risk-return decisions.

AIRB risk measurement models are approved by the ERC, on the recommendation of the Group Model Assessment Committee ("MAC") and the Bank's Model Assessment Forum ("MAF"). The Bank's MAF supports the ERC in ensuring risk identification and measurement capabilities are objective and consistent, so that risk control and risk origination decisions are properly informed. Prior to review by the MAF, all AIRB models are validated in detail by a model validation team, which is separate from the teams which develop and maintain the models. Models undergo a detailed annual review. Reviews are also triggered if the performance of a model deteriorates materially against predetermined thresholds during the ongoing model performance monitoring process.

Credit Approval

The Bank has been locally incorporated since 1 July 2004. Since then, the approval process reflects that strategic decisions are being made in accordance with individual managers' delegated authorities and the terms of reference of the appropriate committees. It is recognised that, as a major part of the Group, all significant risk decisions emanating from Hong Kong will have an impact to the Group, be it regulatory, concentration, strategic, etc. It is therefore recognised that it is essential for the Group to consider such transactions to ensure that these Group issues are included as part of the decision making process. Delegated authorities approved by the ERC are delegated to the key risk managers to ensure that all risk decisions are made within the Bank. Where proposals fall outside of the individual's authorities, the advice and guidance of the Group is sought. In such cases, the relevant Group authority, whether an individual or a committee, will review the proposal from a Group perspective and give their recommendation. On receipt of such recommendation, the Bank's Excess Approval Committee ("EAC"), being a sub-committee of the ERC, will meet to consider such advice and reach a suitable decision. All the credit applications approved by the EAC will be reported at each ERC meeting for noting.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(a) Credit risk (continued)*****Credit concentration risk***

Credit concentration risk is managed within concentration caps set by counterparty or groups of connected counterparties, by country and industry in Corporate & Institutional Clients and Commercial Clients; and tracked by product in Retail Clients. Additional targets are set and monitored for concentrations by credit rating.

Credit concentrations are monitored by the ERC and concentration limits that are material to the Bank are reviewed and approved at least annually by the ERC.

Credit monitoring

The Bank and its subsidiaries regularly monitor credit exposures, portfolio performance, and external trends that may impact risk management outcomes.

Internal risk management reports are presented to risk committees, containing information on key environmental, political and economic trends across major portfolios and countries; portfolio delinquency and loan impairment performance; as well as AIRB portfolio metrics including credit grade migration.

The Bank's Regional Credit Issues Forum ("RCIF") (previously known as Country Credit Issues Forum) meets regularly to assess the impact of external events and trends on the Corporate & Institutional Clients and Commercial Clients credit risk portfolio and to define and implement the Bank's response in terms of appropriate changes to portfolio shape, portfolio and underwriting standards, risk policy and procedures.

Client accounts are placed on Early Alert when they display signs of actual or potential weakness. For example where there is a decline in the client's position within the industry, a financial deterioration, a breach of covenants, non-performance of an obligation, or there are issues relating to ownership or management.

Such accounts and portfolios are subjected to a dedicated process overseen by the Credit Issues Committee ("CIC"). This is to maintain an effective oversight over the existing Early Alert portfolio. Client account plans and credit grades are re-evaluated and remedial actions are agreed and monitored. Remedial actions include, but are not limited to, exposure reduction, security enhancement, exiting the account or immediate movement of the account into the control of Group Special Assets Management ("GSAM"), the Bank's specialist recovery unit.

The Retail Clients Credit Issues Forum ("CIF") is a sub-forum of the ERC. The CIF meets regularly to assess relevant credit matters, which include market developments with direct credit implications, credit policy changes, prominent or emerging credit concerns, portfolio performance monitoring, and mitigating actions.

In Retail Clients, portfolio performance and delinquency trends are monitored continuously at various detailed segment levels. Individual customer behaviour is also tracked and considered for lending decisions. Accounts that are past due are subject to collections processes, managed independently by the Risk function. Charged-off accounts are managed by a specialist recovery team.

The Business Clients segment is managed within Retail Clients. The credit processes are managed through Programmed Lending, in line with Retail Clients procedures with specific controls and limits designed for Business Clients lending.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(a) Credit risk (continued)*****Credit mitigation***

Potential credit losses from any given account, customer or portfolio are mitigated using a range of tools such as collateral, netting agreements, credit insurance, credit derivatives and other guarantees. The reliance that can be placed on these mitigants is carefully assessed in light of issues such as legal enforceability, market value and counterparty risk of the guarantor.

Risk mitigation policies determine the eligibility of collateral types. Collateral types which are eligible for risk mitigation include: cash; residential, commercial and industrial property; fixed assets such as motor vehicles, aircraft, plant and machinery; marketable securities; commodities; bank guarantees; and letters of credit.

Collateral is valued in accordance with the Bank's risk mitigation policy, which prescribes the frequency of valuation for different collateral types. The valuation frequency is driven by the level of price volatility of each type of collateral and the nature of the underlying product or risk exposure.

In Corporate & Institutional Clients and Commercial Clients, the effectiveness of credit mitigation is ensured by policies which govern eligibility criteria such as monitoring of concentration of collateral, correlation of the collateral to underlying assets, adjustments for currency fluctuations for collateral. For all credit risk mitigation that meets the policy criteria, a clear set of procedures are applied to ensure that the value of the underlying collateral is appropriately recorded and updated regularly.

In Retail Clients, effective use of collateral is a key tool by which credit risk is mitigated. All eligible collateral accepted by Retail Clients is covered by a product proposal approved by senior credit officers delegated with the relevant authority. New collateral types have to be vetted through a stringent 'New Business Approval' process and are approved in accordance with the delegated authorities within Retail Clients Risk Committee. In order to be recognised as security and for the loan to be classified as secured, all items pledged must be valued and an active secondary resale market must exist for the collateral. Documentation must be held to enable Retail Clients to realise the asset without the cooperation of the asset owner in the event that this is necessary.

Detailed procedures over collateral management are in place for each business.

Traded Products

Credit risk from traded products is managed within the overall credit risk appetite for corporates and financial institutions.

The credit risk exposure from traded products is derived from the positive mark-to-market value of the underlying instruments, and an additional component to cater for potential market movements.

For derivative contracts, the Bank limits its exposure to credit losses in the event of default by entering into master netting agreements with certain counterparties. As required by HKAS 32/IAS 32, exposures are presented on a gross basis in the financial statements as such transactions are not intended to be settled net in the ordinary course of business.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)***Traded Products (continued)*

In addition, the Bank enters into Credit Support Annexes (“CSA”) with counterparties where collateral is deemed a necessary or desirable mitigant to the exposure. Under a variation margin process, additional collateral is called from the counterparty if total uncollateralised mark-to-market exposure exceeds the threshold and minimum transfer amount specified in the CSA. With certain counterparties, the CSA is reciprocal and requires the Bank to post collateral if the overall mark-to-market value of positions is in the counterparty’s favour and exceeds an agreed threshold.

Securities

Within Corporate & Institutional Clients and Commercial Clients, the Group’s Underwriting Committee (“UC”) (as approved by the Bank’s Board) approves the portfolio limits and parameters for the underwriting and purchase of all pre-defined securities assets to be held for sale. The UC is established under the authority of the Board and under advice of the Group. Corporate & Institutional Clients and Commercial Clients operates within set limits, which include country, single issuer, holding period and credit grade limits.

Day to day credit risk management activities for traded securities are carried out by Traded Credit Risk Management whose activities include oversight and approval within the levels delegated by the UC. Issuer credit risk, including settlement and pre-settlement risk, is controlled by Corporate & Institutional Clients and Commercial Clients Risk, while price risk is controlled by Market and Traded Credit Risk function (“MTCR”).

The UC approves individual proposals to underwrite new corporate security issues for clients. Where an underwritten security is held for a period longer than the target sell-down period, the final decision on whether to sell the position rests within the Risk function.

Maximum exposure to credit risk

The maximum exposures to credit risk of on-balance sheet financial instruments, before taking account of any collateral or other credit enhancements is the carrying amount reported on the balance sheet. For off-balance sheet instruments, the maximum exposure to credit risk excludes loan commitments which are unconditionally cancellable is the contractual nominal amounts as set out below:

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2014</i>	<i>2013</i>	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Financial guarantees and other credit related contingent liabilities	28,046	39,936	28,050	39,945
Loan commitments and other credit related commitments	28,970	35,268	28,372	34,576
	<u>57,016</u>	<u>75,204</u>	<u>56,422</u>	<u>74,521</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)***(i) Loans and advances*

The requirement for collateral is not a substitute for the ability to pay, however, which is the primary consideration for any lending decisions. In determining the financial effect of collateral held against loans neither past due nor impaired, we have assessed the significance of the collateral held in relation to the type of lending.

Loans neither past due nor impaired

At 31 December 2014, the Bank and its subsidiaries have HK\$195,366 million (2013: HK\$179,179 million) of mortgage loans in Retail Clients that are neither past due nor impaired. These are generally fully secured exposures (2013: fully secured).

In Corporate & Institutional Clients and Commercial Clients, the Bank and its subsidiaries have HK\$196,678 million (2013: HK\$209,586 million) of corporate exposures that are neither past due nor impaired. Based on the fair value of the collateral held, 25% (2013: 27%) of these exposures are secured by tangible collateral.

The Bank and its subsidiaries also undertake collateralised lending and borrowing (reverse repos and repos) arrangements, and the collateral held against these types of loans are set out in note 39 to the financial statements.

Non-tangible collateral – such as guarantees and letters of credit – may also be held against corporate exposures although the financial effect of this type of collateral is less significant in terms of recoveries. It is not practicable to quantify the effect of this collateral as the value of the collateral is conditional on circumstances at the time of default and other credit related factors.

Loans past due or impaired

The fair value of collateral held against past due or impaired loans is detailed in the table below as at 31 December:

Consolidated

	2014		2013	
	<i>Advances to customers HK\$'M</i>	<i>Advances to banks HK\$'M</i>	<i>Advances to customers HK\$'M</i>	<i>Advances to banks HK\$'M</i>
Estimated fair value of collateral (Note):				
Held against impaired advances	725	–	567	–
Held against past due but not impaired advances	2,570	–	2,361	–
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)***(i) Loans and advances (continued)**Loans past due or impaired (continued)***Bank**

	2014		2013	
	Advances to customers HK\$'M	Advances to banks HK\$'M	Advances to customers HK\$'M	Advances to banks HK\$'M
Estimated fair value of collateral (Note):				
Held against impaired advances	725	–	559	–
Held against past due but not impaired advances	2,570	–	2,180	–

(Note) The fair value of the collateral held represents fair value, after taking into account the effects of over-collateralisation where it is not available for offset against other loans.

Repossessed Collateral

As at 31 December, the amount of assets obtained by taking possession of collateral held as security were as follows:

	Consolidated		Bank	
	2014 HK\$'M	2013 HK\$'M	2014 HK\$'M	2013 HK\$'M
Property, plant and equipment	229	110	229	93

Loan collateral acquired from borrowers due to restructuring or their inability to repay, continues to be recorded as “Advances to customers” in the balance sheet at the lower of fair value (less costs to sell) and the carrying amount of the loan (net of any impairment allowances), until the collateral is realised.

Repossessed collateral obtained are intended to be realised in an orderly fashion to repay the impaired loans and are not held for the own use of the Bank and its subsidiaries.

(ii) Off-balance sheet exposures

For certain types of exposures such as letters of credit and guarantees, the Bank and its subsidiaries obtain collateral such as cash depending on internal credit risk assessments. However, for trade finance products such as letters of credit, the Bank and its subsidiaries will normally hold legal title to the underlying assets should a default take place.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)**Credit quality*(i) Analysis of the loan portfolio***Consolidated**

	2014		2013	
	<i>Advances to customers</i> <i>HK\$'M</i>	<i>Advances to banks</i> <i>HK\$'M</i>	<i>Advances to customers</i> <i>HK\$'M</i>	<i>Advances to banks</i> <i>HK\$'M</i>
Loans and advances				
– neither past due nor impaired	450,427	145,757	449,135	125,787
– past due but not impaired	3,650	13	3,535	35
– impaired, net of individually assessed impairment provision	1,272	–	1,553	46
Less: collectively assessed impairment provision	(353)	–	(665)	–
	<u>454,996</u>	<u>145,770</u>	<u>453,558</u>	<u>125,868</u>

Bank

	2014		2013	
	<i>Advances to customers</i> <i>HK\$'M</i>	<i>Advances to banks</i> <i>HK\$'M</i>	<i>Advances to customers</i> <i>HK\$'M</i>	<i>Advances to banks</i> <i>HK\$'M</i>
Loans and advances				
– neither past due nor impaired	448,287	145,744	436,026	125,776
– past due but not impaired	3,650	13	3,199	35
– impaired, net of individually assessed impairment provision	1,133	–	1,469	46
Less: collectively assessed impairment provision	(353)	–	(508)	–
	<u>452,717</u>	<u>145,757</u>	<u>440,186</u>	<u>125,857</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(a) Credit risk (continued)***(i) Analysis of the loan portfolio (continued)*

The following tables set out an analysis of the internal credit gradings for advances which are not past due and for which no individual impairment provision has been raised. The credit gradings set out in the tables below are based on a probability of default measure as set out on page 80.

Consolidated

	2014		2013	
	Advances to customers HK\$'M	Advances to banks HK\$'M	Advances to customers HK\$'M	Advances to banks HK\$'M
Credit grades:				
1 to 5	291,715	145,050	265,953	124,397
6 to 8	119,307	523	136,836	1,239
9 to 11	37,625	184	43,624	151
12	1,780	–	2,722	–
	<u>450,427</u>	<u>145,757</u>	<u>449,135</u>	<u>125,787</u>

Bank

	2014		2013	
	Advances to customers HK\$'M	Advances to banks HK\$'M	Advances to customers HK\$'M	Advances to banks HK\$'M
Credit grades:				
1 to 5	291,715	145,037	264,551	124,386
6 to 8	117,228	523	131,812	1,239
9 to 11	37,564	184	37,491	151
12	1,780	–	2,172	–
	<u>448,287</u>	<u>145,744</u>	<u>436,026</u>	<u>125,776</u>

The following tables set out the ageing of advances which are past due and for which no individual impairment provision has been raised. A loan is considered to be past due when the counterparty has failed to make a principal or interest payment when contractually due. Past due does not necessarily mean that the counterparty is impaired.

Consolidated

	2014		2013	
	Advances to customers HK\$'M	Advances to banks HK\$'M	Advances to customers HK\$'M	Advances to banks HK\$'M
Past due				
– up to 30 days	3,319	13	3,109	35
– 31 - 60 days	145	–	233	–
– 61 - 90 days	97	–	99	–
– 91 - 120 days	51	–	57	–
– 121 - 150 days	38	–	37	–
	<u>3,650</u>	<u>13</u>	<u>3,535</u>	<u>35</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)***(i) Analysis of the loan portfolio (continued)***Bank**

	2014		2013	
	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M
Past due				
– up to 30 days	3,319	13	2,852	35
– 31 - 60 days	145	–	190	–
– 61 - 90 days	97	–	63	–
– 91 - 120 days	51	–	57	–
– 121 - 150 days	38	–	37	–
	<u>3,650</u>	<u>13</u>	<u>3,199</u>	<u>35</u>

*(ii) Analysis of debt securities (including certificates of deposit), equity shares and treasury bills***Consolidated and Bank**

	2014			
	<i>Treasury bills</i> HK\$'M	<i>Debt securities</i> HK\$'M	<i>Equity shares</i> HK\$'M	<i>Total</i> HK\$'M
Impaired securities	–	–	34	34
Impairment provisions	–	–	(15)	(15)
Net impaired securities	–	–	19	19
Securities neither past due nor impaired	<u>56,440</u>	<u>140,724</u>	<u>1,971</u>	<u>199,135</u>
	2013			
	<i>Treasury bills</i> HK\$'M	<i>Debt securities</i> HK\$'M	<i>Equity shares</i> HK\$'M	<i>Total</i> HK\$'M
Impaired securities	–	–	33	33
Impairment provisions	–	–	(15)	(15)
Net impaired securities	–	–	18	18
Securities neither past due nor impaired	<u>79,382</u>	<u>154,897</u>	<u>1,521</u>	<u>235,800</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)**

- (ii) *Analysis of debt securities (including certificates of deposit), equity shares and treasury bills (continued)*

The following table analyses debt securities (including certificates of deposit) and treasury bills which are neither past due nor impaired by external credit rating. The standard credit ratings used by the Bank are those used by Standard & Poors or their equivalent. Debt securities held which have a short-term rating are reported against the long-term rating of the issuer.

Consolidated and Bank

	2014		2013	
	<i>Treasury bills</i> HK\$'M	<i>Debt securities</i> HK\$'M	<i>Treasury bills</i> HK\$'M	<i>Debt securities</i> HK\$'M
AAA	–	39,413	–	27,106
AA - to AA +	56,278	43,109	79,382	61,380
A - to A +	162	51,612	–	59,374
Lower than A -	–	2,348	–	3,508
Unrated	–	4,242	–	3,529
	<u>56,440</u>	<u>140,724</u>	<u>79,382</u>	<u>154,897</u>

(b) Country cross-border risk

Country cross-border risk is the risk that the Bank will be unable to obtain payment from its customers or third parties on their contractual obligations as a result of certain actions taken by foreign governments, chiefly relating to convertibility and transferability of foreign currency.

The ERC is responsible for approving country cross-border risk limits.

Assets which generate country cross-border exposure are those where the main source of repayment or security is derived from a country other than the country in which the asset is booked. These cover a wide range of products including loans and advances, interest-bearing deposits with other banks, trade and other bills, acceptances, amounts receivable under finance leases, derivatives, certificates of deposit and other negotiable paper, investment securities and formal commitments. Cross-border assets also include exposures to local residents denominated in currencies other than the local currency and local currency assets funded by intra-group funding. Cross-border exposure also includes the value of commodity, aircraft and shipping assets owned by the Group that are held in a given country.

(c) Market risk management**Market risk**

The Bank recognises market risk as the potential for loss of earnings or economic value due to adverse changes in financial market rates or prices. The Bank's exposure to market risk arises principally from client-driven transactions. The objective of our market risk policies and processes is to obtain the best balance of risk and return whilst meeting clients' requirements.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(c) Market risk management (continued)

Market risk (continued)

The primary categories of market risk for the Bank are:

- interest rate risk: arising from changes in yield curves, credit spreads and implied volatilities on interest rate options;
- currency exchange rate risk: arising from changes in exchange rates and implied volatilities on foreign exchange options;
- commodity price risk: arising from changes in commodity prices and commodity option implied volatilities; covering energy, precious metals, base metals and agriculture;
- equity price risk: arising from changes in the prices of equities, equity indices, equity baskets and implied volatilities on related options.

Market risk governance

The ERC approves the Bank's overall market risk Value-at-Risk ("VaR") and stress loss triggers taking account of market volatility, the range of products and asset classes, business volumes and transaction sizes and is also responsible for policies and other standards for the control of market risk and overseeing their effective implementation. These policies cover both trading and non-trading books of the Bank.

The Market and Traded Credit Risk function ("MTCR") approves the limits within delegated authorities and monitors exposures against these limits. Additional limits are placed on specific instruments and position concentrations where appropriate. Sensitivity measures are used in addition to VaR as risk management tools. For example, interest rate sensitivity is measured in terms of exposure to a one basis point increase in yields.

Value at Risk

The Bank measures the risk of losses arising from future potential adverse movements in market rates, prices and volatilities using a VaR methodology. VaR, in general, is a quantitative measure of market risk that applies recent historical market conditions to estimate the potential future loss in market value that will not be exceeded in a set time period at a set statistical confidence level. VaR provides a consistent measure that can be applied across trading businesses and products over time and can be set against actual daily trading profit and loss outcome.

VaR is calculated for expected movements over a minimum of one business day and to a confidence level of 97.5 per cent. This confidence level suggests that potential daily losses, in excess of the VaR measure, are likely to be experienced six times per year.

The Bank applies two VaR methodologies:

- Historical simulation: involves the revaluation of all existing positions to reflect the effect of historically observed changes in market risk factors on the valuation of the current portfolio. This approach is applied for general market risk factors and the majority of specific (credit spread) risk VaR.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(c) Market risk management (continued)****Value at Risk (continued)**

- Monte Carlo simulation: this methodology is similar to historical simulation but with considerably more input risk factor observations. These are generated by random sampling techniques, but the results retain the essential variability and correlations of historically observed risk factor changes. This approach is applied for some of the specific (credit spread) risk VaR in relation to idiosyncratic exposures in credit markets.

In both methods, an historical observation period of one year is chosen and applied.

Stress Testing

Losses beyond the 97.5 per cent confidence interval are not captured by a VaR calculation. Therefore VaR calculation gives no indication of the size of unexpected losses in these situations.

MTCR complements the VaR measurement by performing a weekly stress testing of market risk exposures to highlight the potential risk that may arise from extreme market events that are rare but plausible.

Stress testing is an integral part of the market risk management framework and considers both historical market events and forward-looking scenarios. A consistent stress testing methodology is applied to trading and non-trading books. The stress testing methodology assumes that scope for management action would be limited during a stress event, reflecting the decrease in market liquidity that often occurs.

Stress scenarios are regularly updated to reflect changes in risk profile and economic events. MTCR reviews stress exposures and, where necessary, enforces reductions in overall market risk exposure. The ERC considers the results of stress tests as part of its supervision of risk appetite.

Regular stress test scenarios are applied to interest rates, credit spreads, exchange rates and commodity prices. This covers all asset classes in the Financial Markets banking and trading books.

Ad hoc scenarios are also prepared reflecting specific market conditions and for particular concentrations of risk that arise within the business.

Market risk VaR coverage

Interest rate risk from non-trading book portfolios is transferred to Financial Markets where it is managed by the Asset Liability Management (ALM) desk under the supervision of ALCO. ALM deals in the market in approved financial instruments in order to manage the net interest rate risk, subject to approved VaR and risk limits.

VaR and stress tests are therefore applied to these non-trading book exposures in the same way as for the trading book, including available-for-sale securities. Securities classed as “Loans and Receivables” or “Held to maturity” are not reflected in VaR or stress tests since they are accounted on an amortised cost basis. Therefore, market price movements have limited effect on either profit and loss or reserves.

Structural foreign exchange currency risks are managed by Group Treasury, and are not included within VaR. Otherwise, the non-trading book does not run open foreign exchange positions.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(c) Market risk management (continued)****Market risk VaR coverage (continued)**Trading and Non-trading (VaR at 97.5%, 1 day)

Value at risk:	2014				2013			
	Average	High	Low	Actual*	Average	High	Low	Actual*
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Interest rate risk [^]	45.3	60.0	35.0	38.6	51.2	65.9	40.3	40.3
Foreign exchange risk	2.4	5.7	1.1	4.4	9.1	22.1	2.9	17.9
Commodity risk	–	–	–	–	0.8	2.0	0.2	1.3
Total ^{^^}	<u>45.9</u>	<u>60.9</u>	<u>34.7</u>	<u>38.5</u>	<u>52.6</u>	<u>71.7</u>	<u>39.5</u>	<u>47.7</u>

Trading (VaR at 97.5%, 1 day)

Value at risk:	2014				2013			
	Average	High	Low	Actual*	Average	High	Low	Actual*
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Interest rate risk	9.9	14.1	6.8	9.0	15.2	29.9	9.9	11.0
Foreign exchange risk	2.4	5.7	1.1	4.4	9.1	22.1	2.9	17.9
Commodity risk	–	–	–	–	0.8	2.0	0.2	1.3
Total ^{^^}	<u>10.2</u>	<u>14.0</u>	<u>6.9</u>	<u>8.6</u>	<u>20.1</u>	<u>47.8</u>	<u>11.4</u>	<u>21.3</u>

Non-trading (VaR at 97.5%, 1 day)

Value at risk:	2014				2013			
	Average	High	Low	Actual*	Average	High	Low	Actual*
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Interest rate risk [^]	<u>40.3</u>	<u>51.5</u>	<u>31.3</u>	<u>36.0</u>	<u>47.2</u>	<u>62.7</u>	<u>37.2</u>	<u>37.8</u>

* Actual one day VaR at period end date.

[^] Interest rate risk VaR includes credit spread risk arising from securities held for trading or available-for-sale.^{^^} The total VaR shown in the tables above is not a sum of the component risks due to offsets between them. Total included trading book equity risk that is insignificant.**(d) Foreign exchange risk**

The foreign exchange positions of the Bank and its subsidiaries arise from foreign exchange trading and commercial banking operations. Foreign exchange trading exposures are principally derived from customer driven transactions. The MTCR approves foreign exchange limits within delegated authorities and monitors exposures against these limits. The net option position is calculated on the basis of the delta-weighted positions of all foreign exchange option contracts.

Foreign exchange risk on the non-trading book portfolios is minimised by match funding assets and liabilities in the same currency.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(d) Foreign exchange risk (continued)**

The Bank and its subsidiaries had the following non-structural foreign currency positions which exceeded 10% of the net non-structural position in all foreign currencies:

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
US dollars exposure		
Spot assets	373,653	354,480
Spot liabilities	(340,519)	(299,956)
Forward purchases	669,828	598,709
Forward sales	(696,706)	(650,692)
Net option position	–	–
	<u>6,256</u>	<u>2,541</u>
Net long non-structural position	<u>6,256</u>	<u>2,541</u>
	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Chinese renminbi exposure		
Spot assets	135,189	118,819
Spot liabilities	(97,721)	(117,545)
Forward purchases	477,387	451,310
Forward sales	(516,333)	(453,433)
Net option position	–	–
	<u>(1,478)</u>	<u>(849)</u>
Net short non-structural position	<u>(1,478)</u>	<u>(849)</u>
	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
New Taiwan dollars exposure		
Spot assets	4,272	3,934
Spot liabilities	(50)	(220)
Forward purchases	431	544
Forward sales	(4,476)	(3,444)
Net option position	–	–
	<u>177</u>	<u>814</u>
Net long non-structural position	<u>177</u>	<u>814</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(d) Foreign exchange risk (continued)**

The Bank and its subsidiaries had the following structural foreign currency positions which exceeded 10% of the net structural position in all foreign currencies:

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Chinese Renminbi	7,803	6,335
US dollars	1,570	1,001
	<u>9,373</u>	<u>7,336</u>

(e) Interest rate risk

The Bank's interest rate exposures comprise trading exposures and non-trading structural interest rate exposures. Structural interest rate risk generally arises from the differing re-pricing characteristics of commercial banking assets and liabilities.

Interest rate risk from the non-trading book portfolios is transferred to Financial Markets . Financial Markets manages these risks with oversight by the Asset and Liability Committee ("ALCO") and within limits approved by the MTCR. VaR and stress tests are applied to non-trading book interest rate exposures in the same way as for the trading book.

The Bank has established principles, policies and techniques for managing interest rate risk. Interest rate risk management is governed by the ALCO.

(f) Liquidity risk

Liquidity risk is the risk that the Bank either does not have sufficient financial resources available to meet all its obligations as they fall due, or can only access these financial resources at excessive cost.

It is the Bank's policy to maintain adequate liquidity at all times and hence to be in a position to meet obligations as they fall due. The Bank manages liquidity risk both on a short-term and structural basis. In the short-term, the focus is on ensuring that the cash flow demands can be met where required. In the medium-term, the focus is on ensuring the balance sheet remains structurally sound and aligned to the Bank's strategy.

Policies and procedures

The Bank's policy is to manage liquidity without presumption of Group support. ALCO is responsible for ensuring that the Bank is able to meet all of its obligations to make payments as they fall due, and operates within regulatory and internal limits.

The Bank's liquidity risk management framework requires limits to be set for prudent liquidity management. There are limits on:

- The local and foreign currency cash flow gaps
- The level of external wholesale borrowing to ensure that the size of this funding is proportionate to the local market and operations

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(f) Liquidity risk (continued)****Policies and procedures (continued)**

- The level of lending and borrowing within the Group
- Commitments, both on and off balance sheet, to ensure there are sufficient funds available in the event of drawdown on these commitments
- The advances to deposits ratio to ensure that commercial advances are funded by stable sources and that customer lending is funded by customer deposits
- The amount of assets that may be funded from other currencies
- The amount of medium term assets that have to be funded by medium term funding

Financial Markets is responsible for the day-to-day management of all the liquidity risk in the Bank, executing liquidity directives and operating within the liquidity policy and approved limits. All limits are reviewed at least annually, and more frequently if required, to ensure that they remain relevant given market conditions and business strategy. Compliance with limits is monitored independently on a regular basis. Limit excesses are escalated and approved under a delegated authority structure and reviewed by ALCO.

The Bank has significant levels of marketable securities, including government securities that can be realised, repurchased or used as collateral in the event of liquidity stress. The Bank prescribes three liquidity stress scenarios that assume accelerated withdrawal of deposits over a period of time. Under such scenarios, the Bank ensures that cash inflows exceed outflows. The Bank also has a Country Funding Crisis Response and Recovery Plan (“CFCRRP”), reviewed and approved annually. The CFCRRP strengthens existing governance processes by providing a broad set of Early Warning Indicators (“EWIs”), an escalation framework and a set of management actions that could be effectively implemented by the appropriate level of senior management in the event of a liquidity stress.

A substantial portion of our assets are funded by customer deposits, largely made up of current and savings accounts. Wholesale funding deposits are widely diversified by type and maturity and represent a stable source of funds for the Bank. In addition, the short term nature of our wholesale assets results in a balance sheet that is funded conservatively.

The ALCO monitors trends in the balance sheet and ensures that any concerns that might impact the stability of these deposits are addressed effectively. The ALCO also reviews balance sheet plans to ensure that projected asset growth is matched by growth in customer deposits.

Customer assets are as far as possible funded in the same currency. Where mismatch arise, they are controlled by limits on the amount of foreign currency that can be swapped to local currency and vice versa. Such limits are therefore a means of controlling reliance on foreign exchange markets, which minimizes the risk that obligations could not be met in the required currency in the event that access to foreign exchange markets becomes restricted. In sizing the limits, we consider a range of factors including:

- The size and depth of local FX markets; and
- The local regulatory environment, particularly the presence or risk of imposition of foreign exchange controls.

Moreover, professional markets are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and optimising asset and liability maturities.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****Liquidity metrics**

The Bank monitors key liquidity metrics on a regular basis. The key metrics are:

(1) Advances to deposits ratio

This is defined as the ratio of total loans and advances to customers relative to total customer deposits. A low advances to deposits ratio demonstrates that customer deposits exceed customer loans resulting from emphasis placed on generating a high level of stable funding from customers.

	<i>Consolidated</i>	
	2014	2013
	HK\$'M	HK\$'M
Advances to customers	454,996	453,558
Deposits from customers	851,029	817,428
Advances to deposits ratio	<u>53%</u>	<u>55%</u>

(2) Liquidity Coverage Ratio ("LCR")

The Bank monitors the LCR in line with the Bank of International Settlements and Hong Kong Monetary Authority's guidelines. The Bank will commence reporting of its LCR on a monthly basis to its local regulator, the Hong Kong Monetary Authority (HKMA) from 2015 onwards.

(3) Other liquidity metrics

A range of short-term and structural liquidity metrics are monitored to ensure a robust liquidity strategy in line with the Bank's overall risk appetite. The contractual medium term funding ratio is intended to highlight reliance on the ability of the Bank to rollover short term liabilities to fund medium term assets based on the Bank's contractual obligations. The behavioural medium term funding ratio is intended to highlight whether the Bank's business / product mix and balance sheet structure in a business-as-usual environment is sustainable over time. The Maximum Cumulative Outflow report allows the Bank to manage any mismatches in the maturity of cash inflows and outflows. Intraday liquidity risk, wholesale borrowing capacity and outflows due to off-balance sheet commitments are also monitored.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(f) Liquidity risk (continued)****Liquidity management – stress scenarios**

The Bank conducts a range of liquidity related stress analyses, both for internal and regulatory purposes. Internally, three stress tests are run routinely: an acute 8-day name specific stress, a 30-day market wide stress and a 30-day combined name specific and market wide stress.

The 8-day stress is specifically designed to determine a minimum quantity of marketable securities that must be held at all times. This stress is computed daily, and the minimum marketable securities requirement is observed daily. This is intended to ensure that, in the unlikely event of an acute loss of confidence in the Bank, there is sufficient time to take corrective action. No support from Group is presumed.

The Bank is also exposed to the risk of market-wide disruption. It is therefore appropriate to test resilience to unexpected local market disruption, for example loss of interbank money markets. The 30-day marketwide and the 30-day combined name specific and marketwide stress scenarios are constructed to examine cashflow needs and assess the resilience of the Bank in such severe but plausible stress events.

Total derivative exposure is less than 5% of the Bank's balance sheet.

The Bank's credit ratings as at the end of December 2014 were AA- (S&P) and Aa3 (Moody's). A downgrade in credit rating would increase derivative collateral requirements. The impact of a 2-notch downgrade has a minimal impact on the Bank's derivative collateral requirements.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(i) Contractual maturity of assets and liabilities**

The table analyses assets and liabilities in relevant maturity groupings based on the remaining period to the contractual maturity date as at the balance sheet date on a discounted basis. Contractual maturities do not necessarily reflect actual repayments or cash flow. Within the tables below cash and balances with banks, central banks and other financial institutions, placements with banks and other financial institutions, and trading assets are used by the Bank principally for liquidity management purposes.

Consolidated

	Repayable on demand HK\$'M	2014					Undated HK\$'M	Total HK\$'M
		Due within 1 month HK\$'M	Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M		
Assets								
Cash and balances with banks, central banks and other financial institutions	53,076	-	-	-	-	-	-	53,076
Placements with banks and other financial institutions	120	85,808	18,442	39,611	1,789	-	-	145,770
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	36,741	36,741
Trading assets	-	1,562	3,338	4,087	10,219	2,645	1,537	23,388
Financial assets designated at fair value	-	-	-	-	62	1,513	-	1,575
Advances to customers	19,153	80,048	35,368	61,735	112,252	148,234	(1,794)	454,996
Investment securities	234	33,011	30,810	30,242	61,394	16,158	453	172,302
Amounts due from group companies	13,202	51,259	9,162	20,089	22,703	1,463	(1,554)	116,324
Others	756	1,799	7,909	4,186	5,291	4,583	50,346	74,870
Total Assets	86,541	253,487	105,029	159,950	213,710	174,596	85,729	1,079,042
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	36,741	36,741
Deposits and balances of banks and other financial institutions	28,402	2,683	595	14	911	-	-	32,605
Deposits from customers	563,433	131,109	92,598	62,644	1,221	24	-	851,029
Trading liabilities	-	12,333	135	235	56	-	41	12,800
Financial liabilities designated at fair value	-	169	1,456	4,780	2,714	5,796	-	14,915
Debt securities in issue	-	9,796	3,930	90	22	-	-	13,838
Amounts due to group companies	6,133	2,428	6,060	2,253	2,331	1,648	-	20,853
Subordinated liabilities	-	-	-	-	-	10,406	-	10,406
Others	8,215	6,069	3,793	868	212	599	56	19,812
Total Liabilities	606,183	164,587	108,567	70,884	7,467	18,473	36,838	1,012,999

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(f) Liquidity risk (continued)**

(i) Contractual maturity (continued)

Consolidated (continued)

	Repayable on demand HK\$'M	2013					Undated HK\$'M	Total HK\$'M
		Due within 1 month HK\$'M	Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M		
Assets								
Cash and balances with banks, central banks and other financial institutions	26,885	-	-	-	-	-	-	26,885
Placements with banks and other financial institutions	35	63,653	32,309	28,291	1,580	-	-	125,868
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	34,581	34,581
Trading assets	-	6,312	5,965	9,371	12,589	3,520	1,104	38,861
Financial assets designated at fair value	-	-	-	9	77	2,068	-	2,154
Advances to customers	11,242	85,066	35,627	59,526	121,406	141,738	(1,047)	453,558
Investment securities	270	35,807	37,026	56,237	60,164	9,242	435	199,181
Amounts due from group companies	8,515	35,369	15,387	14,103	15,657	1,408	(1,570)	88,869
Others	313	2,525	10,767	1,245	419	125	38,881	54,275
Total Assets	47,260	228,732	137,081	168,782	211,892	158,101	72,384	1,024,232
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	34,581	34,581
Deposits and balances of banks and other financial institutions	13,898	261	183	-	1,871	-	-	16,213
Deposits from customers	515,633	137,102	89,238	73,111	2,320	24	-	817,428
Trading liabilities	-	22,597	214	420	100	-	216	23,547
Financial liabilities designated at fair value	-	750	262	2,097	1,324	1,290	-	5,723
Debt securities in issue	-	3,732	10,058	1,546	-	-	-	15,336
Amounts due to group companies	4,475	2,676	7,451	5,699	2,132	432	-	22,865
Subordinated liabilities	-	-	-	-	-	10,548	-	10,548
Others	6,317	7,440	6,980	1,585	51	510	62	22,945
Total Liabilities	540,323	174,558	114,386	84,458	7,798	12,804	34,859	969,186

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(i) Contractual maturity (continued)****Bank**

	Repayable on demand HK\$'M	2014					Undated HK\$'M	Total HK\$'M
		Due within 1 month HK\$'M	Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M		
Assets								
Cash and balances with banks, central banks and other financial institutions	53,064	-	-	-	-	-	-	53,064
Placements with banks and other financial institutions	120	85,797	18,442	39,609	1,789	-	-	145,757
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	36,741	36,741
Trading assets	-	1,562	3,338	4,087	10,219	2,645	1,537	23,388
Financial assets designated at fair value	-	-	-	-	62	1,513	-	1,575
Advances to customers	19,010	79,954	34,705	60,352	112,252	148,234	(1,790)	452,717
Investment securities	234	33,011	30,810	30,242	61,394	16,158	453	172,302
Amounts due from group companies	12,406	51,506	12,223	23,914	39,349	26,521	(1,554)	164,365
Others	732	1,189	6,392	1,219	122	-	8,950	18,604
Total Assets	85,566	253,019	105,910	159,423	225,187	195,071	44,337	1,068,513
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	36,741	36,741
Deposits and balances of banks and other financial institutions	28,402	2,683	595	14	911	-	-	32,605
Deposits from customers	563,433	131,109	92,598	62,644	1,221	24	-	851,029
Trading liabilities	-	12,333	135	235	56	-	41	12,800
Financial liabilities designated at fair value	-	169	1,456	4,780	2,714	5,796	-	14,915
Debt securities in issue	-	9,796	3,930	90	22	-	-	13,838
Amounts due to group companies	7,533	2,459	6,467	2,189	2,331	1,648	-	22,627
Subordinated liabilities	-	-	-	-	-	10,406	-	10,406
Others	8,212	4,189	3,026	727	-	-	56	16,210
Total Liabilities	607,580	162,738	108,207	70,679	7,255	17,874	36,838	1,011,171

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(i) Contractual maturity (continued)****Bank (continued)**

	Repayable on demand HK\$'M	2013					Undated HK\$'M	Total HK\$'M
		Due within 1 month HK\$'M	Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M		
Assets								
Cash and balances with banks, central banks and other financial institutions	26,697	-	-	-	-	-	-	26,697
Placements with banks and other financial institutions	35	63,644	32,309	28,289	1,580	-	-	125,857
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	34,581	34,581
Trading assets	-	6,312	5,965	9,371	12,589	3,520	1,104	38,861
Financial assets designated at fair value	-	-	-	9	77	2,068	-	2,154
Advances to customers	11,149	84,547	34,835	56,161	116,924	137,451	(881)	440,186
Investment securities	270	35,807	37,026	56,237	60,164	9,242	435	199,181
Amounts due from group companies	7,405	36,238	17,860	17,603	29,256	18,016	(1,570)	124,808
Others	309	1,585	10,514	747	227	-	9,382	22,764
Total Assets	45,865	228,133	138,509	168,417	220,817	170,297	43,051	1,015,089
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	34,581	34,581
Deposits and balances of banks and other financial institutions	13,898	191	8	-	911	-	-	15,008
Deposits from customers	515,632	136,708	88,770	72,856	2,310	24	-	816,300
Trading liabilities	-	22,597	214	420	100	-	216	23,547
Financial liabilities designated at fair value	-	750	262	2,097	1,324	1,290	-	5,723
Debt securities in issue	-	3,732	10,058	1,546	-	-	-	15,336
Amounts due to group companies	5,162	2,835	7,998	5,666	2,048	432	-	24,141
Subordinated liabilities	-	-	-	-	-	10,548	-	10,548
Others	6,317	7,188	6,727	1,279	-	-	22	21,533
Total Liabilities	541,009	174,001	114,037	83,864	6,693	12,294	34,819	966,717

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(i) Contractual maturity (continued)****Consolidated and Bank**

	Repayable on demand	2014					Undated	Total
		Due within 1 month	Due between 1 month to 3 months	Due between 3 months to 1 year	Due between 1 year to 5 years	Due after 5 years		
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
Of which:								
Certificates of deposit held								
- included in Trading assets	-	50	2	302	7	13	-	374
- included in Investment securities as available-for-sale securities	-	381	9,044	4,715	946	-	-	15,086
	-	431	9,046	5,017	953	13	-	15,460
Treasury bills								
- included in Trading assets	-	832	1,737	447	-	-	-	3,016
- included in Investment securities as available-for-sale securities	-	31,529	17,645	4,250	-	-	-	53,424
	-	32,361	19,382	4,697	-	-	-	56,440
Debt securities								
- included in Trading assets	-	508	1,387	2,904	8,602	2,440	-	15,841
- included in Financial assets designated at fair value	-	-	-	-	62	1,513	-	1,575
- included in Investment securities classified as:								
- available-for-sale securities	-	1,101	4,121	21,044	52,081	16,158	-	94,505
- loans and receivables	234	-	-	233	8,367	-	-	8,834
- included in Amounts due from fellow subsidiaries classified as:								
- available-for-sale securities	-	-	-	-	4,509	-	-	4,509
	234	1,609	5,508	24,181	73,621	20,111	-	125,264

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(i) Contractual maturity (continued)****Consolidated and Bank (continued)**

	Repayable on demand HK\$'M	2013					Undated HK\$'M	Total HK\$'M
		Due within 1 month HK\$'M	Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M		
Of which:								
Certificates of deposit held								
- included in Trading assets	-	44	-	1,369	259	97	-	1,769
- included in Investment securities as available-for-sale securities	-	9,442	12,402	11,932	961	-	-	34,737
	-	9,486	12,402	13,301	1,220	97	-	36,506
Treasury bills								
- included in Trading assets	-	5,852	3,330	4,048	-	-	-	13,230
- included in Investment securities as available-for-sale securities	-	22,325	22,046	21,781	-	-	-	66,152
	-	28,177	25,376	25,829	-	-	-	79,382
Debt securities								
- included in Trading assets	-	230	2,480	3,237	8,681	3,254	-	17,882
- included in Financial assets designated at fair value	-	-	-	9	77	2,068	-	2,154
- included in Investment securities classified as:								
- available-for-sale securities	-	4,040	2,093	22,233	54,032	9,242	-	91,640
- loans and receivables	270	-	485	291	5,171	-	-	6,217
- included in Amounts due from fellow subsidiaries classified as:								
- available-for-sale securities	-	-	-	-	-	498	-	498
	270	4,270	5,058	25,770	67,961	15,062	-	118,391

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)**

- (ii) Behavioural maturity of financial liabilities on a discounted basis

The cash flows presented in note 37(f)(i) reflect the cash flows which will be contractually payable over the residual maturity of the instruments. However, contractual maturities do not necessarily reflect the timing of actual repayments or cash flow. In practice, certain liability instruments behave differently from their contractual terms and, especially for short term customer accounts, which extend to a longer period than their contractual maturity. Such behavioural adjustments are identified and managed through analysis of the historic behaviour of balances. The Bank's expectation of when liabilities are likely to become due is provided on the following page. No information has been presented for financial liabilities which will become payable on their contractual due dates.

Consolidated

	2014				Total HK\$'M
	Within 3 months HK\$'M	Between 3 months and 1 year HK\$'M	Between 1 year and 5 years HK\$'M	After 5 years HK\$'M	
Deposits and balances of banks and other financial institutions	31,680	14	911	–	32,605
Deposits from customers	122,812	93,099	635,118	–	851,029
Total	154,492	93,113	636,029	–	883,634

	2013				Total HK\$'M
	Within 3 months HK\$'M	Between 3 months and 1 year HK\$'M	Between 1 year and 5 years HK\$'M	After 5 years HK\$'M	
Deposits and balances of banks and other financial institutions	14,338	–	1,875	–	16,213
Deposits from customers	164,659	91,907	560,862	–	817,428
Total	178,997	91,907	562,737	–	833,641

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(ii) Behavioural maturity of financial liabilities on a discounted basis (continued)****Bank**

	2014				Total HK\$'M
	<i>Within 3 months HK\$'M</i>	<i>Between 3 months and 1 year HK\$'M</i>	<i>Between 1 year and 5 years HK\$'M</i>	<i>After 5 years HK\$'M</i>	
Deposits and balances of banks and other financial institutions	31,680	14	911	–	32,605
Deposits from customers	122,812	93,099	635,118	–	851,029
Total	154,492	93,113	636,029	–	883,634

	2013				Total HK\$'M
	<i>Within 3 months HK\$'M</i>	<i>Between 3 months and 1 year HK\$'M</i>	<i>Between 1 year and 5 years HK\$'M</i>	<i>After 5 years HK\$'M</i>	
Deposits and balances of banks and other financial institutions	14,093	–	915	–	15,008
Deposits from customers	163,796	91,652	560,852	–	816,300
Total	177,889	91,652	561,767	–	831,308

(iii) Financial liabilities (excluding derivative financial instruments on an undiscounted basis)

The following tables analyse the contractual cash flows payable for the bank's financial liabilities by remaining contractual maturity on an undiscounted basis. The financial liability balances in the tables below will not agree to the balances reported in the balance sheets as the tables incorporate all contractual cash flows, on an undiscounted basis, relating to both principal and interest payments. The cash flows presented in the tables reflect the cash flows which will be contractually payable over the residual maturity of the instruments. In practice, however, the liability instruments behave differently from their contractual terms and typically, for short term customer accounts, extend to a longer period than their contractual maturity.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)**

(iii) Financial liabilities excluding derivative financial instruments on an undiscounted basis (continued)

Consolidated

	2014						Total HK\$'M
	Repayable on demand HK\$'M	Due within 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M	Undated HK\$'M	
Deposits and balances of banks and other financial institutions	28,402	3,283	14	933	–	–	32,632
Deposits from customers	563,433	224,371	63,135	1,264	24	–	852,227
Trading liabilities	–	11,987	–	–	–	41	12,028
Financial liabilities designated at fair value	–	1,637	4,821	3,507	5,480	–	15,445
Debt securities in issue	–	13,727	91	22	–	–	13,840
Amounts due to group companies	6,134	8,489	2,255	2,342	1,648	–	20,868
Subordinated liabilities	–	–	522	2,094	10,750	–	13,366
Others	7,954	9,478	729	213	599	36,797	55,770
	<u>605,923</u>	<u>272,972</u>	<u>71,567</u>	<u>10,375</u>	<u>18,501</u>	<u>36,838</u>	<u>1,016,176</u>
	2013						Total HK\$'M
	Repayable on demand HK\$'M	Due within 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M	Undated HK\$'M	
Deposits and balances of banks and other financial institutions	13,899	446	–	1,894	–	–	16,239
Deposits from customers	515,633	227,087	73,967	2,410	24	–	819,121
Trading liabilities	–	22,239	–	–	–	216	22,455
Financial liabilities designated at fair value	–	1,024	2,119	1,354	1,354	–	5,851
Debt securities in issue	–	13,801	1,549	–	–	–	15,350
Amounts due to group companies	4,475	10,126	5,706	2,158	432	–	22,897
Subordinated liabilities	–	–	530	2,126	11,489	–	14,145
Others	5,853	13,893	1,398	–	510	34,603	56,257
	<u>539,860</u>	<u>288,616</u>	<u>85,269</u>	<u>9,942</u>	<u>13,809</u>	<u>34,819</u>	<u>972,315</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)**

(iii) Financial liabilities excluding derivative financial instruments on an undiscounted basis (continued)

Bank

	Repayable on demand HK\$'M	Due within 3 months HK\$'M	2014		Due after 5 years HK\$'M	Undated HK\$'M	Total HK\$'M
			Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M			
Deposits and balances of banks and other financial institutions	28,402	3,283	14	933	–	–	32,632
Deposits from customers	563,433	224,371	63,135	1,264	24	–	852,227
Trading liabilities	–	11,987	–	–	–	41	12,028
Financial liabilities designated at fair value	–	1,637	4,821	3,507	5,480	–	15,445
Debt securities in issue	–	13,727	91	22	–	–	13,840
Amounts due to group companies	7,531	8,928	2,191	2,342	1,648	–	22,640
Subordinated liabilities	–	–	522	2,094	10,750	–	13,366
Others	7,951	6,733	688	–	–	36,797	52,169
	<u>607,317</u>	<u>270,666</u>	<u>71,462</u>	<u>10,162</u>	<u>17,902</u>	<u>36,838</u>	<u>1,014,347</u>
	Repayable on demand HK\$'M	Due within 3 months HK\$'M	2013		Due after 5 years HK\$'M	Undated HK\$'M	Total HK\$'M
			Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M			
Deposits and balances of banks and other financial institutions	13,899	199	–	934	–	–	15,032
Deposits from customers	515,632	226,223	73,710	2,399	24	–	817,988
Trading liabilities	–	22,239	–	–	–	216	22,455
Financial liabilities designated at fair value	–	1,024	2,119	1,354	1,354	–	5,851
Debt securities in issue	–	13,801	1,549	–	–	–	15,350
Amounts due to group companies	5,162	10,833	5,674	2,074	432	–	24,175
Subordinated liabilities	–	–	530	2,126	11,489	–	14,145
Others	5,853	13,326	1,238	–	–	34,603	55,020
	<u>540,546</u>	<u>287,645</u>	<u>84,820</u>	<u>8,887</u>	<u>13,299</u>	<u>34,819</u>	<u>970,016</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)**

(iv) Derivative financial instruments on an undiscounted basis

The following tables show the maturity of derivative financial instruments including those net settled derivative contracts in a net liability position, together with the pay leg of gross settled contracts regardless of whether the overall contract is in an asset or liability position. The receiving leg is not shown in this table and as a result the derivative amounts in this table are inflated by their exclusion.

Consolidated

	<i>Due within 3 months HK\$'M</i>	<i>Due between 3 months to 1 year HK\$'M</i>	<i>Due between 1 year to 5 years HK\$'M</i>	<i>Due after 5 years HK\$'M</i>	<i>Total HK\$'M</i>
	2014				
Derivative financial instruments	833,363	540,553	27,853	5,428	1,407,197
	2013				
Derivative financial instruments	711,796	523,144	37,937	3,941	1,276,818

Bank

	<i>Due within 3 months HK\$'M</i>	<i>Due between 3 months to 1 year HK\$'M</i>	<i>Due between 1 year to 5 years HK\$'M</i>	<i>Due after 5 years HK\$'M</i>	<i>Total HK\$'M</i>
	2014				
Derivative financial instruments	833,363	540,553	27,853	5,428	1,407,197
	2013				
Derivative financial instruments	711,796	523,144	37,935	3,939	1,276,814

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(g) Operational risk**

Operational risk is the potential for loss arising from the failure of people, process or technology or the impact of external events. We seek to minimize our exposure to operational risk. Operational risk exposures are managed through a consistent set of management processes that drive risk identification, assessment, control and monitoring.

Operational risks can arise from all business lines and from all activities carried out by the Bank.

Operational Risk Framework (ORF)

The Bank ensures completeness of its management of operational risk by maintaining a complete Process Universe for all business and function processes. This represents all Bank activities, the owners of these activities and the risk and control standards that are defined by risk and process owners. It also serves as the foundation for policy delivery as well as risk identification, measurement, management and reporting. The ORF requires:

- 'Industrial strength' processes for all Bank activities
- Control tolerances for detection and rectification of defects within a defined time period
- Standardised processes except for legitimate system or regulatory exceptions
- Gross and residual risk assessments by First Line and approved by Second Line
- Monthly risk and control monitoring
- Prompt execution of risk treatment actions to closure

This is being implemented for Hong Kong on a risk-prioritised basis with residual risk assessments due to be available in 2015 to inform on the Group's underlying control environment performance.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(g) Operational risk (continued)

Although operational risk exposures can take many varied forms, we seek to manage them in accordance with standards that drive systematic risk identification, assessment, control and monitoring. These standards are challenged and reviewed regularly to ensure their ongoing effectiveness. To support the systematic identification of material operational risk exposures associated with a given process, we classify them into the following types:

Operational Risk Subtypes

Processing failures	Potential for loss due to failure of an established process or a process design weakness
External Rules & Regulations	Potential for actual or opportunity loss due to failure to comply with laws or regulations, or as a result of changes in laws or regulations or in their interpretation or application
Liability	Potential for loss or sanction due to a legal claim against any part of the Group or individuals within the Group
Legal enforceability	Potential for loss due to failure to protect legally the Group's interests or from difficulty in enforcing the Group's rights
Damage to assets	Potential for loss or damage to physical assets and other property from natural disaster and other events
Safety and security	Potential for loss or damage to health or safety of staff, customers or third parties arising from internal failures or the effects of external events
Internal crime or dishonesty	Potential for loss due to action by staff that is intended to defraud, misappropriate property or to circumvent the law or company policy
External crime	Potential for loss due to criminal acts by external parties such as fraud, theft and other criminal activity
Model	Potential for loss due to a significant discrepancy between the output of risk measurement models and actual experience

The ERC oversees the management of operational risks across the Bank, supported by business and functional level committees. This formal structure of governance provides the Board with confidence that operational risks are being proactively identified and effectively managed.

The ERC is responsible for setting and maintaining standards for operational risk management and measurement.

The ORF and operational risk policies are aligned to the RMF and establish clear rules and standards for the effective management of operational risk across all levels of the organisation. Operational risk policies are reviewed and revised regularly to ensure their ongoing effectiveness and alignment to the Bank's operational risk profile and appetite.

The Country Operational Risk Committee ("CORC") is a sub-committee of the ERC and is responsible for the supervision and management of operational risks across the Bank. CORC is also responsible for ensuring adequate and appropriate policies and procedures, and resources are in place for identification, assessment, monitoring, control and reporting of operational risks.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(g) Operational risk (continued)**

In addition, specialist operational risk control owners have responsibility for the management of operational risk arising from the following Bank-wide activities: legal processes, people management, technology management, vendor management, property management, security management, accounting and financial control, tax management, corporate authorities and structure and regulatory compliance. Each risk control owner is responsible for identifying risks that are material to the Bank and for maintaining an effective control environment, which includes defining appropriate policies and procedures for approval by authorized risk committees.

Compliance with operational risk policies and procedures is the responsibility of all managers within the Bank. Corporate & Institutional Clients, Commercial Clients and Retail Clients businesses have independent Operational Risk teams reporting to the Risk Function to ensure operational risk is effectively managed. These units are responsible for approving operational controls, ensuring compliance with policies and procedures in the business, monitoring material operational risk exposures, and providing guidance to the respective business areas on operational risk management.

(h) Reputational risk

Reputational risk could arise from the failure by the Bank to effectively mitigate the risks in its businesses including one or more of country, credit, liquidity, market, regulatory, legal, strategic or other operational risk. Damage to the Bank's reputation could cause existing clients to reduce or cease to do business with the Bank and prospective clients to be reluctant to do business with the Bank. All employees are responsible for day to day identification and management of reputational risk. These responsibilities form part of the Code of Conduct and are further embedded through values-based performance assessments. Risk Control Owners must identify material reputational risks arising from any business activity or transaction that they control and ensure that these are escalated and controlled in accordance with the Reputational Risk Policy and applicable procedures.

Reputational risk may also arise from a failure to comply with environmental and social standards. Our primary environmental and social impacts arise through our relationship with our clients and customers and the financing decisions we take. The Group has published a series of Position statements that we apply in the provision of financial services to clients who operate in sectors with specific risks, and for key issues. We have mechanisms in our origination and credit processes to identify and assess environmental and social risks, and a dedicated Environmental and Social Risk Management team that reviews proposed transactions with identified risks.

The ERC and its sub-committee, the Responsibility and Reputational Risk Committee, provides Bank-wide oversight on reputational risk, sets policy and monitors material risks. The Head of Corporate Affairs is the overall risk control owner for reputational risk. The ExCo provides additional oversight of reputational risk on behalf of the Board.

The Head of Corporate Affairs as risk control owner is responsible for the protection of the Bank's reputation with the support of the country management team. The Head of Corporate Affairs and Chief Executive Officer must actively:

- Promote awareness and application of the Bank's policies and procedures regarding reputational risk.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(h) Reputational risk (continued)**

- Encourage businesses and functions to take account of the Bank's reputation in all decision-making, including dealings with customers and suppliers.
- Implement effective in-country reporting systems to ensure they are aware of all potential issues in tandem with respective business committees.
- Promote effective, proactive stakeholder management through ongoing engagement.

(i) Pension risk

Pension risk is the potential for loss due to having to meet an actuarially assessed shortfall in the Bank's pension scheme. Pension risk exposure is not concerned with the financial performance of the Bank's pension scheme but is focused upon the risk to the Bank's financial position arising from the need to meet pension scheme funding obligations. The risk assessment is focused on our obligations towards the Bank's pension scheme, ensuring that our funding obligation is comfortably within our financial capacity. Pension risk is monitored on a semi-annual basis taking account of the actual variations in asset values and updated expectations regarding the progression of the pension fund assets and liabilities.

The CPC is the body responsible for governance of pension risk and it receives its authority from ExCo.

(j) Capital management

The HKMA sets and monitors capital requirements for the Bank and certain subsidiaries specified by the HKMA. In implementing current capital requirements, the HKMA requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. The Bank calculates its capital adequacy ratios in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance.

In addition to meeting the regulatory requirements, the Bank's primary objectives when managing capital are to safeguard the Bank and its subsidiaries' ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost. The Bank actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might otherwise be possible with greater gearing and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

The process of allocating capital to specific operations and activities is undertaken by ALCO and is reviewed regularly by the Board.

Consistent with industry practice, the Bank monitors its capital structure on the basis of the capital adequacy ratio and there have been no material changes in the Bank's policy on the management of capital during the year.

The Bank and its subsidiaries have complied with all externally imposed capital requirements throughout the years ended 31 December 2014 and 2013.

The Bank uses the AIRB approach for both the measurement of credit risk capital and the management of credit risk for the majority of its portfolios. The Bank also uses the standardised (credit risk) approach for certain insignificant portfolios exempted from AIRB. The Bank adopts the internal ratings-based (securitization) approach to calculate its credit risk for securitization exposures.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(j) Capital management (continued)

For market risk, the Bank uses an internal models approach for two guaranteed funds and the standardized (market risk) approach for other exposures. In addition, the Bank adopts the standardized (operational risk) approach for operational risk.

The Banking (Capital) Rules issued by the HKMA require all authorized institutions in Hong Kong to meet three levels of minimum capital ratios, namely common equity tier 1, tier 1 and total capital ratios.

The Bank's consolidated capital as at 31 December 2014 consists of tier 1 capital after deduction of HK\$51,577 million (2013: HK\$42,474 million) and tier 2 capital after deductions of HK\$10,867 million (2013: HK\$11,348 million). Tier 2 capital includes subordinated debt and collective impairment allowances for impaired assets.

38 Financial instruments

(a) Valuation of financial instruments carried at fair value

Valuation of financial assets and liabilities held at fair value are subject to a review independent of the business by Valuation Control. For those financial assets and liabilities whose fair value is determined by reference to externally quoted prices or market observable pricing inputs to valuation models, an assessment is made against external market data and consensus services. Financial instruments held at fair value in the balance sheet have been classified into a valuation hierarchy that reflects the significance of the inputs used in the fair value measurements.

Valuation methodologies

The valuation hierarchy, and the types of instruments classified into each level within that hierarchy, is set out below:

	Level 1	Level 2	Level 3
Fair value determined using:	Unadjusted quoted price in an active market for identical assets and liabilities	Valuation models with directly or indirectly market observable inputs (note 1)	Valuation models using significant non-market observable inputs (see note 38 (a) (i))
Types of financial assets	Actively traded government, agency and other securities Listed equities Quoted derivative instruments	Asset backed securities Corporate and other government bonds and loans Over-the-counter derivatives	Asset backed securities in illiquid markets Corporate bonds and loans in illiquid markets Unlisted equities Over-the-counter derivatives with unobservable inputs
Types of financial liabilities	Short positions in actively traded government and agency securities Short positions in listed equities Quoted derivative instruments	Structured bank and customer deposits Debt securities in issue Over-the-counter derivatives	Structured bank and customer deposits Debt securities issued Over-the-counter derivatives with unobservable inputs

(Note 1) These valuation models included discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. These models incorporate assumptions and inputs that other market participants would use in their valuations, such as discount rates, default rates, credit spreads and option volatilities. These inputs need to be directly or indirectly observable in order to be classified as level 2.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)**

The tables below show the classification of financial instruments held at fair value into the valuation hierarchy set out above as at 31 December:

Consolidated

	2014			Total HK\$'M
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	
Trading assets				
– Trading securities	16,251	4,517	–	20,768
– Advances to customers	–	1,604	–	1,604
– Positive fair values of trading derivatives	1	1,015	–	1,016
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	–	4,784	33	4,817
– Positive fair values of hedging derivatives	–	833	–	833
Amounts due from fellow subsidiaries				
– Listed available-for-sale debt securities	–	4,509	–	4,509
– Positive fair values of trading derivatives	–	1	–	1
– Positive fair values of hedging derivatives	–	103	–	103
Financial assets designated at fair value				
– Debt securities	–	1,513	62	1,575
Available-for-sale securities				
– Treasury bills	53,424	–	–	53,424
– Certificates of deposit held	–	15,086	–	15,086
– Debt securities	39,646	54,859	–	94,505
– Equity shares, net of impairment	71	1	381	453
Total assets measured at fair value	109,393	88,825	476	198,694
Trading liabilities				
– Short positions in securities	11,995	–	–	11,995
– Negative fair values of trading derivatives	1	804	–	805
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	7,519	9	7,528
– Debt securities issued	–	6,735	652	7,387
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	–	5,570	10	5,580
– Negative fair values of hedging derivatives	–	1,196	–	1,196
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	1	–	1
Total liabilities measured at fair value	11,996	21,825	671	34,492

There were no significant transfers between level 1 and level 2 instruments in 2014.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****Consolidated (continued)**

	2013			Total HK\$'M
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	
Trading assets				
– Trading securities	25,777	8,208	–	33,985
– Advances to customers	–	3,983	–	3,983
– Positive fair values of trading derivatives	1	892	–	893
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	1	10,513	1	10,515
– Positive fair values of hedging derivatives	–	718	–	718
Amounts due from fellow subsidiaries				
– Listed available-for-sale debt securities	–	–	498	498
– Positive fair values of trading derivatives	–	43	–	43
Financial assets designated at fair value				
– Debt securities	–	2,071	83	2,154
Available-for-sale securities				
– Treasury bills	66,152	–	–	66,152
– Certificates of deposit held	–	34,737	–	34,737
– Debt securities	27,914	63,089	637	91,640
– Equity shares, net of impairment	82	–	353	435
Total assets measured at fair value	119,927	124,254	1,572	245,753
Trading liabilities				
– Short positions in securities	22,417	–	–	22,417
– Negative fair values of trading derivatives	–	1,130	–	1,130
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	3,832	65	3,897
– Debt securities issued	–	1,826	–	1,826
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	2	10,617	12	10,631
– Negative fair values of hedging derivatives	–	948	–	948
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	44	–	44
– Negative fair values of hedging derivatives	–	96	–	96
Total liabilities measured at fair value	22,419	18,493	77	40,989

There were no significant transfers between level 1 and level 2 instruments in 2013.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****Bank**

	2014			
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	Total HK\$'M
Trading assets				
– Trading securities	16,251	4,517	–	20,768
– Advances to customers	–	1,604	–	1,604
– Positive fair values of trading derivatives	1	1,015	–	1,016
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	–	4,782	33	4,815
– Positive fair values of hedging derivatives	–	833	–	833
Amounts due from fellow subsidiaries				
– Listed available-for-sale debt securities	–	4,509	–	4,509
– Positive fair values of trading derivatives	–	1	–	1
– Positive fair values of hedging derivatives	–	103	–	103
Financial assets designated at fair value				
– Debt securities	–	1,513	62	1,575
Available-for-sale securities				
– Treasury bills	53,424	–	–	53,424
– Certificates of deposit held	–	15,086	–	15,086
– Debt securities	39,646	54,859	–	94,505
– Equity shares, net of impairment	71	1	381	453
Total assets measured at fair value	<u>109,393</u>	<u>88,823</u>	<u>476</u>	<u>198,692</u>
Trading liabilities				
– Short positions in securities	11,995	–	–	11,995
– Negative fair values of trading derivatives	1	804	–	805
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	7,519	9	7,528
– Debt securities issued	–	6,735	652	7,387
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	–	5,570	10	5,580
– Negative fair values of hedging derivatives	–	1,196	–	1,196
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	1	–	1
Total liabilities measured at fair value	<u>11,996</u>	<u>21,825</u>	<u>671</u>	<u>34,492</u>

There were no significant transfers between level 1 and level 2 instruments in 2014.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****Bank (continued)**

	2013			
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	Total HK\$'M
Trading assets				
– Trading securities	25,777	8,208	–	33,985
– Advances to customers	–	3,983	–	3,983
– Positive fair values of trading derivatives	1	892	–	893
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	1	10,509	1	10,511
– Positive fair values of hedging derivatives	–	718	–	718
Amounts due from fellow subsidiaries				
– Listed available-for-sale debt securities	–	–	498	498
– Positive fair values of trading derivatives	–	43	–	43
Financial assets designated at fair value				
– Debt securities	–	2,071	83	2,154
Available-for-sale securities				
– Treasury bills	66,152	–	–	66,152
– Certificates of deposit held	–	34,737	–	34,737
– Debt securities	27,914	63,089	637	91,640
– Equity shares, net of impairment	82	–	353	435
Total assets measured at fair value	119,927	124,250	1,572	245,749
Trading liabilities				
– Short positions in securities	22,417	–	–	22,417
– Negative fair values of trading derivatives	–	1,130	–	1,130
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	3,832	65	3,897
– Debt securities issued	–	1,826	–	1,826
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	2	10,617	12	10,631
– Negative fair values of hedging derivatives	–	948	–	948
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	44	–	44
– Negative fair values of hedging derivatives	–	96	–	96
Total liabilities measured at fair value	22,419	18,493	77	40,989

There were no significant transfers between level 1 and level 2 instruments in 2013.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****(i) Valuation of financial instruments with significant unobservable inputs**

The movements during the year for level 3 financial assets and liabilities are as follows:

Consolidated and Bank

	<i>Financial assets designated at fair value HK\$'M</i>	<i>Amounts due from immediate holding company HK\$'M</i>	<i>2014 Amounts due from fellow subsidiaries (Note 1) HK\$'M</i>	<i>Available- for-sale securities HK\$'M</i>	<i>Total level 3 assets HK\$'M</i>
Financial assets					
At 1 January 2014	83	1	498	990	1,572
Total gains recognised in the income statement					
– Net trading income	–	32	–	–	32
– Net gains from financial instruments designated at fair value through profit or loss	5	–	–	–	5
– Net gains from disposal of available-for-sale securities	–	–	2	–	2
Total (losses)/gains recognised in the available-for-sale investment reserve	–	–	(11)	39	28
Purchases	–	–	–	14	14
Sales	–	–	–	(25)	(25)
Settlements	(26)	–	(489)	(199)	(714)
Transferred into level 3 (Note 2)	–	–	–	–	–
Transferred out of level 3 (Note 2)	–	–	–	(438)	(438)
	<u>62</u>	<u>33</u>	<u>–</u>	<u>381</u>	<u>476</u>
At 31 December 2014					
Total gains recognised in the income statement relating to assets held at 31 December 2014					
– Net trading income	–	32	–	–	32
– Net gains from financial instruments designated at fair value through profit or loss	3	–	–	–	3

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****(i) Valuation of financial instruments with significant unobservable inputs (continued)**

	<i>Financial liabilities designated at fair value</i> HK\$'M	<i>Amounts due to immediate holding company</i> HK\$'M	<i>Total level 3 liabilities</i> HK\$'M
Financial liabilities			
At 1 January 2014	65	12	77
Total losses/(gains) recognised in the income statement			
– Net trading income	–	(2)	(2)
– Net losses from financial instruments designated at fair value through profit or loss	32	–	32
Issuances	620	–	620
Settlements	(56)	–	(56)
	<u>661</u>	<u>10</u>	<u>671</u>
At 31 December 2014			
Total losses/(gains) recognised in the income statement relating to liabilities held at 31 December 2014			
– Net trading income	–	(2)	(2)
– Net losses from financial instruments designated at fair value through profit or loss	31	–	31
	<u>31</u>	<u>–</u>	<u>31</u>

(Note 1) Amounts due from fellow subsidiaries included debt securities which are available for sale.

(Note 2) Transfers into/(out of) level 3 during the year relate to financial instruments where the valuation parameters became unobservable/(observable) during the year.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****(i) Valuation of financial instruments with significant unobservable inputs (continued)**

	2013					Total level 3 assets HK\$'M
	Financial assets designated at fair value HK\$'M	Amounts due from immediate holding company HK\$'M	Amounts due from fellow subsidiaries (Note 1) HK\$'M	Available- for-sale securities HK\$'M	Derivatives financial instruments HK\$'M	
Financial assets						
At 1 January 2013	548	1	1,403	430	8	2,390
Total gains/(losses) recognised in the income statement						
– Net trading income	–	–	–	–	(8)	(8)
– Net gains from financial instruments designated at fair value through profit or loss	24	–	9	–	–	33
– Net gains/(losses) from disposal of available-for-sale securities	–	–	32	(3)	–	29
Total gains recognised in the available-for-sale investment reserve	–	–	11	86	–	97
Purchases	–	–	–	108	–	108
Sales	–	–	–	(229)	–	(229)
Settlements	(151)	–	(957)	(199)	–	(1,307)
Transferred into level 3 (Note 2)	–	–	–	841	–	841
Transferred out of level 3 (Note 2)	(338)	–	–	(44)	–	(382)
At 31 December 2013	<u>83</u>	<u>1</u>	<u>498</u>	<u>990</u>	<u>–</u>	<u>1,572</u>
Total gains recognised in the income statement relating to assets held at 31 December 2013						
– Net gains from financial instruments designated at fair value through profit or loss	<u>2</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>2</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****(i) Valuation of financial instruments with significant unobservable inputs (continued)**

	<i>Financial liabilities designated at fair value</i>	<i>Amounts due to immediate holding company</i>	<i>Derivatives financial instruments</i>	<i>Total level 3 liabilities</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Financial liabilities				
At 1 January 2013	–	8	1	9
Total losses/(gains) recognised in the income statement				
– Net trading income	–	4	(1)	3
– Net losses from financial instruments designated at fair value through profit or loss	2	–	–	2
Issuances	47	–	–	47
Transferred into level 3 (Note 2)	16	–	–	16
	<u>65</u>	<u>12</u>	<u>–</u>	<u>77</u>
At 31 December 2013				
Total losses recognised in the income statement relating to liabilities held at 31 December 2013				
– Net trading income	–	4	–	4
– Net losses from financial instruments designated at fair value through profit or loss	2	–	–	2
	<u>2</u>	<u>–</u>	<u>–</u>	<u>2</u>

(Note 1) Amounts due from fellow subsidiaries included debt securities which are available for sale and designated at fair value.

(Note 2) Transfers into/(out of) level 3 during the year relate to financial instruments where the valuation parameters became unobservable/(observable) during the year.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

The following table presents the key valuation techniques used to measure the fair value of level 3 financial instruments which are held at fair value, the significant unobservable inputs and the range of values for those inputs and the weighted average of those inputs.

Type of instruments	Principal valuation technique	Significant unobservable inputs	Range (Note 1)	Weighted average (Note 2)
Debt securities	Discounted cash flows	Yield	2.39% to 2.92% (2013: 1.49% to 4.01%)	2.65% (2013: 2.2%)
Structured bank and customer deposits	Internal pricing model	Equity-equity correlation	56% to 75% (2013: 45%)	N/A (2013: N/A)
		Equity-foreign exchange correlation	Nil (2013: 44% to 65%)	Nil (2013: N/A)
Debt securities in issue	Discounted cash flows	Credit spreads	4% (2013: Nil)	4% (2013: Nil)
Derivative financial Instruments	Internal pricing model	Equity-equity correlation	56% to 75% (2013: 45%)	N/A (2013: N/A)
		Equity-foreign exchange correlation	Nil (2013: 44% to 65%)	Nil (2013: N/A)
	Discounted cash flows	Credit spreads	4% (2013: Nil)	4% (2013: Nil)

(Note 1) The ranges of values shown represent the highest and lowest levels used in the valuation of the level 3 financial instruments as at 31 December 2014 and 2013. The ranges of values used are reflective of the underlying characteristics of these level 3 financial instruments based on the market conditions at the balance sheet date. However, these ranges of values may not represent the uncertainty in fair value measurements of these level 3 financial instruments.

(Note 2) Weighted average for non-derivative financial instruments have been calculated by weighting inputs by the relative fair value. Weighted average for derivatives has been provided by weighting inputs by the risk relevant to that variable. N/A has been entered for the cases where weighted average is not a meaningful indicator.

(Note 3) Level 3 equity shares, which are mainly measured using unadjusted net asset value, are excluded.

The following section describes the significant unobservable inputs identified in the above valuation technique table.

Yield

Yield is the interest rate that is used to discount the future cash flows in a discounted cash flow model. An increase in the yield, in isolation, would result in a decrease in a fair value measurement.

Correlation

Correlation is the measure of how movement in one variable influences the movement in another variable. In derivative products, where the payoff is subject to the value of more than one underlying, the correlation between two variables is used as an input in determining the value of the product. Examples include correlation between two stocks, a stock and an index, an index and another index etc. Correlation can be high or low as well as positive or negative. Positive high correlation between two variables means that an increase in one variable is expected to cause a similar increase in other variable.

Credit spreads

Credit spreads represent the additional yield that a market participant would demand for taking exposures to the credit risk of an instrument.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)**

(ii) Sensitivities in respect of the fair values of level 3 assets and liabilities

Consolidated and Bank

	2014					
	<i>Held at fair value through profit or loss</i>			<i>Available-for-sale securities</i>		
	<i>Net</i>	<i>Favourable</i>	<i>Unfavourable</i>	<i>Net</i>	<i>Favourable</i>	<i>Unfavourable</i>
	<i>exposure</i>	<i>changes</i>	<i>changes</i>	<i>exposure</i>	<i>changes</i>	<i>changes</i>
<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	
Amounts due from immediate holding company	33	88	(23)	–	–	–
Debt securities	62	62	62	–	–	–
Equity securities	–	–	–	381	419	343
Amounts due to immediate holding company	(10)	(10)	(10)	–	–	–
Structured bank and customer deposits	(9)	(8)	(10)	–	–	–
Debt securities issued	(652)	(608)	(696)	–	–	–
	<u>(576)</u>	<u>(476)</u>	<u>(677)</u>	<u>381</u>	<u>419</u>	<u>343</u>

	2013					
	<i>Held at fair value through profit or loss</i>			<i>Available-for-sale securities</i>		
	<i>Net</i>	<i>Favourable</i>	<i>Unfavourable</i>	<i>Net</i>	<i>Favourable</i>	<i>Unfavourable</i>
	<i>exposure</i>	<i>changes</i>	<i>changes</i>	<i>exposure</i>	<i>changes</i>	<i>changes</i>
<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	
Amounts due from immediate holding company	1	1	1	–	–	–
Amounts due from fellow subsidiaries	–	–	–	498	498	497
Debt securities	83	83	83	637	640	635
Equity securities	–	–	–	353	389	318
Amounts due to immediate holding company	(12)	(12)	(12)	–	–	–
Structured bank and customer deposits	(65)	(58)	(71)	–	–	–
	<u>7</u>	<u>14</u>	<u>1</u>	<u>1,488</u>	<u>1,527</u>	<u>1,450</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

Where the fair value of financial instruments are measured using valuation techniques that incorporate one or more significant inputs which are based on unobservable market data, we apply a 10 per cent increase or decrease on the values of these unobservable parameter inputs, to generate a range of reasonably possible alternative valuations in accordance with the requirements of HKFRS 7/IFRS 7. The percentage shift is determined by statistical analyses performed on a set of reference prices, which included certain equity indices, credit indices and volatility indices, based on the composition of our level 3 financial instruments. Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters. This level 3 sensitivity analysis assumes a one way market move and does not consider offsets for hedges.

As of 31 December 2014, these reasonably possible alternatives could have increased the net fair values of financial instruments held at fair value through profit or loss by HK\$100 million (2013: HK\$7 million) or decreased them by HK\$101 million (2013: HK\$6 million); and increased the fair values of available-for-sale securities by HK\$38 million (2013: HK\$39 million) or decreased them by HK\$38 million (2013: HK\$38 million).

(b) Valuation of financial instruments carried at amortised cost

All financial instruments are stated at fair value or amounts not materially different from their fair value as at 31 December 2014 and 2013, except for subordinated liabilities.

The following table summarises the carrying amounts and fair values (including the valuation hierarchy) of subordinated liabilities. The values in the table below are stated as at 31 December and may be different from the actual amounts that will be received on the settlement or maturity of the subordinated liabilities.

	2014		2013	
	Carrying amount HK\$'M	Fair value Level 1 HK\$'M	Carrying amount HK\$'M	Fair value Level 1 HK\$'M
Subordinated liabilities	10,406	10,973	10,548	11,154

The following sets out the Bank's basis of establishing the fair value of its financial assets and liabilities which are not carried at fair value. The basis for establishing the fair value of financial assets and liabilities held at fair value and of derivatives is set out in note 2(i) and note 2(j), respectively.

Cash and balances with banks, central banks and other financial institutions

The fair value of cash and balances with banks, central banks and other financial institutions is their carrying amounts.

Placements with banks and other financial institutions

The fair value of floating rate placements and overnight deposits is their carrying amounts. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using the prevailing money market rates for debts with a similar credit risk and remaining maturity.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(b) Valuation of financial instruments carried at amortised cost (continued)****Advances to customers**

Advances are net of provisions for impairment. The estimated fair value of advances represents the discounted amount of future cash flows expected to be received, including assumptions relating to prepayment rates and, where appropriate, credit spreads. Expected cash flows are discounted at current market rates to determine fair value.

Deposits and balances of banks, other financial institutions and customers

The estimated fair value of deposits with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on discounted cash flows using the prevailing market rates for debts with a similar credit risk and remaining maturity.

Debt securities in issue and subordinated liabilities

The aggregate fair values are calculated based on quoted market prices. For those securities where quoted market prices are not available, a discounted cash flow model is used based on a current market yield curve appropriate for the remaining term to maturity.

(c) Transfers of financial assets

The Bank enters into collateralised repurchase agreements (repos). These transactions typically entitle the Bank and its counterparties to have recourse to assets similar to those provided as collateral in the event of a default. Assets pledged in respect of repos continue to be recognised on the balance sheet as the Bank retains substantially the associated risk and rewards of these assets. The associated liability is included in "Amounts due to immediate holding company".

The table below sets out the financial assets provided by the Bank as collateral for repos:

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Collateral pledged against repos		
On balance sheet		
Cash	4	4
Off balance sheet		
Repledged collateral received	626	541
	<u>630</u>	<u>545</u>
Balance sheet liabilities - repos		
Amount due to Group companies	622	548
	<u>622</u>	<u>548</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(d) Offsetting financial assets and financial liabilities**

The following tables present details of financial instruments subject to offsetting, enforceable master netting arrangements and similar agreements.

Consolidated

	2014				
	<i>Gross amounts of recognised financial assets</i>	<i>Gross amounts of recognised financial liabilities offset in the balance sheet</i>	<i>Net amounts of financial assets presented in the balance sheet</i>	<i>Related amounts not offset in the balance sheet</i>	<i>Net amount</i>
<i>Assets</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Positive fair values of derivative financial instruments	6,770	–	6,770	(5,797)	973
Reverse repos, securities borrowing and similar agreements	19,538	–	19,538	(19,433)	105
	<u>26,308</u>	<u>–</u>	<u>26,308</u>	<u>(25,230)</u>	<u>1,078</u>
<i>Liabilities</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Negative fair values of derivative financial instruments	7,582	–	7,582	(6,875)	707
Repos and similar agreements	622	–	622	(622)	–
	<u>8,204</u>	<u>–</u>	<u>8,204</u>	<u>(7,497)</u>	<u>707</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(d) Offsetting financial assets and financial liabilities (continued)****Consolidated (continued)**

	2013				
	<i>Gross amounts of recognised financial assets</i>	<i>Gross amounts of recognised financial liabilities offset in the balance sheet</i>	<i>Net amounts of financial assets presented in the balance sheet</i>	<i>Related amounts not offset in the balance sheet</i>	<i>Net amount</i>
<i>Assets</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Positive fair values of derivative financial instruments	12,169	–	12,169	(11,366)	803
Reverse repos, securities borrowing and similar agreements	20,851	–	20,851	(20,664)	187
	<u>33,020</u>	<u>–</u>	<u>33,020</u>	<u>(32,030)</u>	<u>990</u>
<i>Liabilities</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Negative fair values of derivative financial instruments	12,849	–	12,849	(11,366)	1,483
Repos and similar agreements	548	–	548	(545)	3
	<u>13,397</u>	<u>–</u>	<u>13,397</u>	<u>(11,911)</u>	<u>1,486</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(d) Offsetting financial assets and financial liabilities (continued)****Bank**

	2014				
	<i>Gross amounts of recognised financial assets</i>	<i>Gross amounts of recognised financial liabilities offset in the balance sheet</i>	<i>Net amounts of financial assets presented in the balance sheet</i>	<i>Related amounts not offset in the balance sheet</i>	<i>Net amount</i>
<i>Assets</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Positive fair values of derivative financial instruments	6,768	–	6,768	(5,797)	971
Reverse repos, securities borrowing and similar agreements	19,538	–	19,538	(19,433)	105
	<u>26,306</u>	<u>–</u>	<u>26,306</u>	<u>(25,230)</u>	<u>1,076</u>
<i>Liabilities</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Negative fair values of derivative financial instruments	7,582	–	7,582	(6,875)	707
Repos and similar agreements	622	–	622	(622)	–
	<u>8,204</u>	<u>–</u>	<u>8,204</u>	<u>(7,497)</u>	<u>707</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(d) Offsetting financial assets and financial liabilities (continued)****Bank (continued)**

Assets	2013					Net amount HK\$'M
	Gross amounts of recognised financial assets HK\$'M	Gross amounts of recognised financial liabilities offset in the balance sheet HK\$'M	Net amounts of financial assets presented in the balance sheet HK\$'M	Related amounts not offset in the balance sheet HK\$'M		
Positive fair values of derivative financial instruments	12,165	–	12,165	(11,366)		799
Reverse repos, securities borrowing and similar agreements	20,851	–	20,851	(20,664)		187
	<u>33,016</u>	<u>–</u>	<u>33,016</u>	<u>(32,030)</u>		<u>986</u>
Liabilities	Gross amounts of recognised financial liabilities HK\$'M	Gross amounts of recognised financial assets offset in the balance sheet HK\$'M	Net amounts of financial liabilities presented in the balance sheet HK\$'M	Related amounts not offset in the balance sheet HK\$'M		Net amount HK\$'M
Negative fair values of derivative financial instruments	12,849	–	12,849	(11,366)		1,483
Repos and similar agreements	548	–	548	(545)		3
	<u>13,397</u>	<u>–</u>	<u>13,397</u>	<u>(11,911)</u>		<u>1,486</u>

The Bank and its subsidiaries are able to offset assets and liabilities which do not meet the HKAS32/IAS 32 netting criteria (see note 2(l)). Such arrangements include master netting arrangements for derivatives and global master repurchase agreements for repos and reverse repos. These agreements generally allow that all outstanding transactions with a particular counterparty can be offset but only in the event of default or other pre-determined events, therefore the related financial assets and financial liabilities are not offset in the balance sheet.

Under repos and reverse repos, the Bank and its subsidiaries would pledge (legally sell) and obtain (legally purchase) financial collateral which are mainly highly liquid assets which can be sold in the event of a default.

The related amounts not offset in the balance sheet which are disclosed in the table above include financial instruments covered by master netting arrangements and financial collateral pledged and obtained, but exclude the effect of over collateralisation.

39 Assets pledged as security for liabilities

The Bank maintains pledged cash and securities accounts to secure any borrowings or other obligations resulting from the Bank's use of clearing systems and to cover short positions. As at 31 December 2014, the Bank had securities amounting to HK\$11,995 million (2013: HK\$22,417 million) to cover the short positions.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***39 Assets pledged as security for liabilities (continued)**

Reverse repos and securities borrowing transactions

The Bank also undertakes reverse repos and securities borrowing transactions as set out in the table below:

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Balance sheet assets - reverse repos and securities borrowing		
Placements with banks and other financial institutions	19,154	10,790
Advances to customers	384	3,083
Amounts due from Group companies	–	6,978
	<u>19,538</u>	<u>20,851</u>

Under reverse repos and securities borrowing arrangements, the Bank obtains securities on terms that permit it to repledge or resell the securities to others. The amount of securities which the Bank is able to repledge or resell are as follows:

	<i>Consolidated and Bank</i>	
	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Securities and collateral that can be repledged or sold (at fair value)	19,474	20,719
Thereof repledged/transferred to others under repos (at fair value)	<u>626</u>	<u>541</u>

These transactions are conducted under terms that are usual and customary to standard lending and stock borrowing activities.

40 Material related party transactions

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Bank and its subsidiaries entered into the following material related party transactions. The transactions of the Bank are materially the same as those appearing in the consolidated financial statements in 2014 and 2013.

(a) Key management personnel remuneration

Remuneration for key management personnel of the Bank, including amounts paid to the directors as disclosed in note 8 is as follows:

	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Short-term employee benefits	127	120
Post-employment benefits	5	7
Equity compensation benefits	<u>30</u>	<u>32</u>
	<u>162</u>	<u>159</u>

Total remuneration is included in staff costs (see note 4(g)).

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(b) Credit facilities and loans to key management personnel**

During the year, the Bank provided credit facilities to key management personnel of the Bank and their close family members and companies controlled or significantly influenced by them. The credit facilities were provided in the ordinary course of business and on substantially the same terms as for comparable transactions with persons of a similar standing or, where applicable, with other employees.

	<i>2014</i>	<i>2013</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Loan balances:		
At 1 January	105	124
	<u> </u>	<u> </u>
At 31 December	203	105
	<u> </u>	<u> </u>
Average balance during the year	383	109
	<u> </u>	<u> </u>
Income earned	6	1
	<u> </u>	<u> </u>

(c) Share based payments

The Group operates a number of share based payment schemes for its directors and employees.

2011 Standard Chartered Share Plan (the 2011 Plan)

Approved by shareholders in May 2011, this is the Group's main share plan. The 2011 Plan is designed to deliver performance shares, deferred awards and restricted shares, giving the Group sufficient flexibility to meet the challenges of the changing regulatory and competitive environment. Share awards are a key part of both executive directors' and senior management's variable compensation and their significance as a proportion of potential total remuneration is one of the strongest indicators of the Group's commitment to pay for sustainable performance ensuring there is an appropriate return for the risk taken and that a measure is aligned with the Group's risk appetite. Performance and restricted share awards will generally be in the form of nil price options to acquire shares in SC PLC.

Performance shares

Awards of performance shares vest after a three-year period and are subject to a combination of three performance measures, Total Shareholder Return (TSR), Earnings per share (EPS) and Return on Risk Weighted Assets (RoRWA). The three performance measures are equally weighted with one third of the award depending on each measure, assessed independently. Performance share awards form part of the variable compensation awarded to executive directors. In line with regulatory requirements, discretionary variable compensation for executive directors will not exceed 200 per cent of fixed pay.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)**(c) Share based payments (continued)****Deferred share awards/Restricted shares**

Deferred awards are used to deliver the deferred portion of total variable compensation, in line with both market practice and regulatory requirements. These awards are subject to a three-year deferral period, vesting equally one third on each of the first, second and third anniversaries. These awards are not subject to an annual limit to ensure that regulatory requirements relating to deferral levels can be met and in line with market practice of our competitors. Deferred awards will not be subject to any further performance criteria, although the Group's claw-back policy will apply.

Restricted share awards which are made outside of the annual performance process, as additional incentive or retention mechanisms, are provided as restricted shares under the 2011 Plan. These awards vest in equal instalments on the second and the third anniversaries of the award date. In a few circumstances, some awards vest over a four-year period in equal tranches. In line with similar plans operated by our competitors, restricted share awards are not subject to an annual limit and do not have any performance conditions.

1997/2006 Restricted Share Scheme (2006 RSS)/ 2007 Supplementary Restricted Share Scheme (2007 SRSS)

The Group's previous plans for delivering restricted shares were the 2006 RSS and 2007 SRSS, both of which are now replaced by the 2011 Plan. There are vested awards outstanding under these plans. Awards will generally be in the form of nil cost options and do not have any performance conditions. Generally deferred restricted share awards vest equally over three years and for non-deferred awards half vests two years after the date of grant and the balance after three years. No further awards will be granted under the 2006 RSS and 2007 SRSS.

2000 Executive Share Option Scheme (2000 ESOS)

The 2000 ESOS is designed to be internationally competitive and focus executive directors and their senior management teams on delivering long-term performance. An EPS performance criterion must be met before options can be exercised.

Executive share options to purchase ordinary shares in the ultimate holding company are exercisable after the third, but before the tenth anniversary of the date of grant. The exercise price per share is the share price at the date of grant and options can only be exercised if a performance condition is satisfied. No further awards may be granted to the employees of the Bank and its subsidiaries under the 2000 ESOS. There are no outstanding awards under this plan.

2001 Performance Share Plan (2001 PSP)

The Group's previous plan for delivering performance shares was the 2001 PSP. Although the 2001 PSP was replaced in 2011, there are still outstanding vested under the plan.

Under the 2001 PSP, half the award is dependent upon TSR performance and the balance is subject to a target of defined EPS growth. Both measures use the same three-year period and are assessed independently. No further awards can be granted under the plan.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****All Employee Sharesave Plan (2004 International Sharesave, 2004 UK Sharesave and 2013 Sharesave)**

Under the Sharesave schemes, employees have the choice of opening a savings contract. Within a period of six months after the third or fifth anniversary, as appropriate, employees may purchase ordinary shares in the ultimate holding company. The price at which they may purchase shares is at a discount of up to 20 per cent on the share price at the date of invitation. There are no performance conditions attached to options granted under the Sharesave schemes. No further award can be granted under 2004 Sharesave plans.

The Standard Chartered 2013 Sharesave Plan was approved by Shareholders in May 2013 and since then all Sharesave invitations have been made under this plan.

2011 Standard Chartered Share Plan (the 2011 plan)**Performance Shares**

Valuation

The fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period and the relevant performance condition applying to that portion of the award. The fair value of the TSR component is derived by discounting a third of the award that is subject to the TSR condition by the loss of expected dividends over the performance period together with the probability of meeting the TSR condition. The EPS fair value is derived by discounting one third of the award respectively by the loss of expected dividends over the performance period. The same approach is applied to calculate the RoRWA fair value for one third of the award. In respect of the EPS and RoRWA components only, the number of shares expected to vest is adjusted for actual performance when calculating the charge for the year. The same fair value is applied to awards made to both directors and employees of the Group.

Grant Date	2014			2013		
	10 December	18 June	13 March	18 September	19 June	11 March
Share price at grant date (£)	9.34	12.83	11.92	15.14	14.62	18.22
Shares granted	6,781	71	568,381	9,636	9,304	530,166
Vesting period (years)	3	3	3	3	3	3
Expected dividends (yield) (%)	5.7	5.6	5.3	4.6	4.1	4.1
Fair value (EPS) (£)	2.64	3.63	3.40	4.43	4.32	5.38
Fair value (RoRWA) (£)	2.64	3.63	3.40	4.43	4.32	5.38
Fair value (TSR) (£)	1.07	1.48	1.38	1.80	1.76	2.19

The expected dividend yield is based on the historical dividend yield over the three years prior to grant.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)**

A reconciliation of movements for the year to 31 December 2014 and 2013 is shown below:

	2014	2013
	No. of shares	No. of shares
Outstanding at 1 January	1,626,356	1,081,556
Granted	575,233	549,106
Lapsed	(358,901)	(4,306)
Exercised	(121,258)	–
Outstanding at 31 December	1,721,430	1,626,356
Weighted average remaining contractual life	8.16 years	8.30 years
Exercisable at 31 December	40,549	–

Deferred Share Awards

Valuation

The fair value, for all employees including directors, is based on 100% of the face value of the shares at date of grant as the share price will reflect expectations of all future dividends.

Grant Date	2014		2013	
	18 June	13 March	19 June	11 March
Share price at grant date (£)	12.83	11.92	14.62	18.22
Shares granted	1,217	1,226,630	2,955	1,089,867
Vesting period (years)	1/2/3	1/2/3	1/2/3	1/2/3
Expected dividends yield (%)	n/a	n/a	n/a	n/a
Fair value (£)	12.83	11.92	14.62	18.22

Deferred awards accrue dividend equivalent payments during the vesting period.

Restricted Share Awards

Valuation

The fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period. The same fair value is applied for awards made to both the directors and employees of the Group.

Grant Date	2014			
	10 December	17 September	18 June	13 March
Share price at grant date (£)	9.34	12.28	12.83	11.92
Shares granted	27,869	88,253	45,901	4,026
Vesting period (years)	2/3, 1/2/3/4	2/3, 1/2/3/4	2/3, 1/2/3/4	2/3
Expected dividends (yield) (%)	5.5	5.7	6.1	5.8
Fair value (£)	8.17	10.69	11.08	10.37

Grant Date	2013			
	17 December	18 September	19 June	11 March
Share price at grant date (£)	13.04	15.14	14.62	18.22
Shares granted	41,899	47,274	32,729	29,162
Vesting period (years)	2/3	2/3	2/3, 1/2/3/4	2/3, 1/2/3/4
Expected dividends (yield) (%)	4.9	4.6	4.6	4.6
Fair value (£)	11.59	13.54	13.05	16.27

The expected dividend yield is based on the historical dividend yield for three years prior to grant.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****Deferred Share Awards/ Restricted Shares**

A reconciliation of movements for the year to 31 December 2014 and 2013 is shown below:

	<u>2014</u>	<u>2013</u>
	<i>No. of shares</i>	<i>No. of shares</i>
Outstanding at 1 January	2,351,016	1,594,849
Granted	1,393,896	1,243,886
Additional shares for Notional Dividend	72,958	45,126
Lapsed	(128,748)	(88,266)
Exercised	(778,411)	(444,579)
Outstanding at 31 December	2,910,711	2,351,016
Weighted average remaining contractual life	5.50 years	5.76 years
Exercisable at 31 December	193,128	62,995

1997/2006 Restricted Share Scheme (2006 RSS)

No share awards were granted in 2014 and 2013.

A reconciliation of movements for the year ended 31 December 2014 and 2013 is shown below:

	<u>2014</u>	<u>2013</u>
	<i>No. of shares</i>	<i>No. of shares</i>
Outstanding at 1 January	917,138	2,376,041
Additional shares for Notional Dividend	20,632	37,301
Lapsed	(11,301)	(185,733)
Exercised	(598,758)	(1,310,471)
Outstanding at 31 December	327,711	917,138
Weighted average remaining contractual life	2.53 years	3.77 years
Exercisable at 31 December	327,711	343,679

2007 Supplementary Restricted Share Scheme (2007 SRSS)

No share awards were granted in 2014 and 2013.

A reconciliation of movements for the year to 31 December 2014 and 2013 is shown below:

	<u>2014</u>	<u>2013</u>
	<i>No. of shares</i>	<i>No. of shares</i>
Outstanding at 1 January	180,281	446,703
Lapsed	(1,972)	(103,545)
Exercised	(58,543)	(162,877)
Outstanding at 31 December	119,766	180,281
Weighted average remaining contractual life	2.08 years	3.29 years
Exercisable at 31 December	119,766	175,094

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****2000 Executive Share Option Scheme (2000 ESOS)**

No share awards were granted in 2014 and 2013.

A reconciliation of option movements for the year ended 31 December 2014 and 2013 is shown below:

	2014		2013	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	5,840	£7.89	72,734	£7.67
Lapsed	–	–	(32,729)	£7.40
Exercised	(5,840)	£7.89	(34,165)	£7.89
Outstanding at 31 December	–	–	5,840	£7.89
Exercisable at 31 December	–	–	5,840	£7.89

Range of exercise price	2014			2013		
	Weighted average exercise price	No. of shares	Weighted average remaining contractual life	Weighted average exercise price	No. of shares	Weighted average remaining contractual life
N/A (2013: £7.89)	–	–	–	£7.89	5,840	0.17 year

2001 Performance Share Plan (PSP)

No share awards were granted in 2014 and 2013.

A reconciliation of movements for the year ended 31 December 2014 and 2013 is shown below:

	2014	2013
	No. of shares	No. of shares
Outstanding at 1 January	30,800	208,690
Lapsed	(1,321)	(15,859)
Exercised	(11,759)	(162,031)
Outstanding at 31 December	17,720	30,800
Weighted average remaining contractual life	3.38 years	4.39 years
Exercisable at 31 December	17,720	30,800

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****Sharesave (2004 International Sharesave, 2004 UK Sharesave and 2013 Sharesave)**

Valuation

Options are valued using a binomial option-pricing model. The fair value per option granted and the assumptions used in the calculation are as follows:

<i>Grant Date</i>	<u>2014</u>	<u>2013</u>
	<i>8 October</i>	<i>9 October</i>
Share price at grant date (£)	11.12	14.36
Exercise price (£)	9.85	11.78
Shares granted	506,846	424,553
Vesting period (years)	3	3
Expected volatility (%)	25.1	26.8
Expected option life (years)	3.33	3.33
Risk free rate (%)	1.19	0.8
Expected dividends (yield) (%)	5.8	4.3
Fair value (£)	1.61	3.30

The expected volatility is based on historical volatility over the last three to five years, or three years prior to grant. The expected life is the average expected period to exercise. The risk free rate of return is the yield on zero-coupon UK Government bonds of a term consistent with the assumed option life. The expected dividend yield is based on historical dividend yield for three years prior to grant.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****Sharesave (2004 International Sharesave and 2004 UK Sharesave)**

No share awards were granted in 2014 and 2013.

A reconciliation of option movements for the year ended 31 December 2014 and 2013 is shown below:

	2014		2013	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	1,270,791	£11.48	1,749,820	£11.57
Lapsed	(554,367)	£11.69	(261,133)	£12.39
Exercised	(29,316)	£12.25	(217,896)	£11.42
Outstanding at 31 December	687,108	£11.26	1,270,791	£11.48
Exercisable at 31 December	132,559	£10.69	128,677	£14.21

Range of exercise price	2014			2013		
	Weighted average exercise price	No. of shares	Weighted average remaining contractual life	Weighted average exercise price	No. of shares	Weighted average remaining contractual life
£10.65/£14.63 (2013: £9.79/£14.63)	£11.26	687,108	1.26	£11.48	1,270,791	1.95 years

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****2013 Sharesave**

	2014		2013	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	413,113	£11.78	–	–
Granted	506,846	£9.85	424,553	£11.78
Lapsed	(240,857)	£10.88	(11,440)	£11.78
Outstanding at 31 December	679,102	£10.66	413,113	£11.78
Exercisable at 31 December	–	–	–	–

Range of exercise price	2014			2013		
	Weighted average exercise price	No. of shares	Weighted average remaining contractual life	Weighted average exercise price	No. of shares	Weighted average remaining contractual life
£9.85/£11.78 (2013: £11.78)	£10.66	679,102	3 years	£11.78	413,113	3.42 years

(d) Loans to officers

Loans to officers of the Bank disclosed pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

	2014 HK\$'M	2013 HK\$'M
Aggregate amount of relevant loans by the Bank outstanding at 31 December	42	105
Maximum aggregate amount of relevant loans by the Bank outstanding during the year	138	116

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(e) Related party transactions with associates and joint ventures of the Group**

During the year, the Bank and its subsidiaries entered into transactions with associates and joint ventures of the Group in the ordinary course of its banking business and on substantially the same terms as for comparable transactions with third-party counterparties. The amounts of material transactions during the year are set out below:

	2014 HK\$'M	2013 HK\$'M
Amounts due from associates and joint ventures	3	185
Deposits from associates and joint ventures	688	159
Operating income	19	25

41 Ultimate holding company

The Bank's ultimate holding company is Standard Chartered PLC, a company registered in England and Wales. Standard Chartered PLC has listings on the London Stock Exchange and the Stock Exchange of Hong Kong. In addition, Standard Chartered PLC is also listed on the Bombay and National Stock Exchanges of India in a form of Indian Depository Receipts.

42 Significant accounting estimates and judgements

In determining the carrying amounts of certain assets and liabilities, the Bank and its subsidiaries make assumptions about the effects of uncertain future events on those assets and liabilities at the balance sheet date. These estimations and assumptions are based on historical experience and expectation of future events and are reviewed periodically as actual results may differ from these estimates.

Pensions

Actuarial assumptions are made in valuing defined benefit obligations as set out in note 30 and are updated periodically.

Taxes

Determining income tax provisions involves judgement on the future tax treatment of certain transactions. Deferred tax liabilities are recognised on all temporary differences and deferred tax assets are recognised on temporary differences where it is probable that there will be taxable revenue against which these can be offset. Management has made judgements as to the probability of future taxable revenues being generated against which tax losses will be available for offset.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Significant accounting estimates and judgements (continued)*Fair value of financial instruments*

Notes 2(i) and 38 provide further information on the Bank's fair value accounting policy and process.

Impairment of financial assets

Policies on impairment of financial assets are set out in note 2(k).

Goodwill impairment

An annual assessment is made, as set out in note 22, as to whether the current carrying value of goodwill is impaired.

Impairment of interest in associates

Details of impairment testing are set out in note 20.

43 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2014

Up to the date of issue of the financial statements, the HKICPA/IASB has issued a number of new standards which are not yet effective for the accounting year ended 31 December 2014 and which have not been adopted in these financial statements.

These include:

- HKFRS 9/IFRS 9, *Financial instruments* (effective on 1 January 2018)
- HKFRS 15/IFRS 15, *Revenue from contracts with customers* (effective on 1 January 2017)

The Bank and its subsidiaries are in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. It is not yet practicable to quantify the effect on these consolidated financial statements.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***44 Disposal group held for sale**

The assets and liabilities of the disposal group held for sale is summarised below:

	2014 HK\$'M
Assets	
Cash and balances with banks and other financial institution	125
Advances to customers	12,220
Interest in associates	144
Fixed assets	56
Goodwill and intangible assets	525
Other assets	147
	<hr/>
Assets held for sale	13,217
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Liabilities	
Deposits and balances of banks and other financial institutions	1,020
Deposit from customers	808
Other liabilities	174
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Liabilities held for sale	2,002
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45 Comparative Figures

Certain comparative figures have been restated to conform with the current year's presentation (see note 20 and 23).

Unaudited supplementary financial information

Disclosure on Remuneration for CG-5 Guideline on a Sound Remuneration System issued by the HKMA

Pursuant to section 3 of CG-5 on Guideline on a Sound Remuneration System of the Supervisory Policy manual issued by the Hong Kong Monetary Authority and the Pillar 3 disclosure requirements for remuneration by the Basel Committee on Banking Supervision, the following disclosures are made:

- a) Information relating to the governance structure of the remuneration system
- b) Information relating to the design and structure of the remuneration processes
- c) Description of the ways in which current and future risks are taken into account in the remuneration processes
- d) Description of the ways in which the Bank seeks to link performance during a performance measurement period with levels of remuneration
- e) Description of the ways in which the Bank seeks to adjust remuneration to take account of longer-term performance
- f) Description of the different forms of variable remuneration that the Bank utilizes and the rationale for using these different forms
- g) Number of meetings held by the Board Remuneration Committee during the financial year and remuneration paid to the staff

The Bank adopts the remuneration policy and systems of Standard Chartered PLC. Please refer to the Directors' Remuneration Report in the Annual Report of Standard Chartered PLC for details of the Board Remuneration Committee, the major characteristics of the remuneration system, and how risks are taken into account in the remuneration processes.

- h) Aggregate quantitative information on remuneration for Senior Management and Key Personnel (note 1) for the year ended 31 December 2014 and 31 December 2013 are as follows:

Analysis of remuneration split between fixed and variable compensation

	2014		2013	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
Fixed compensation	35,218	10,665	21,600	10,140
Variable compensation				
– Up front cash	11,455	3,669	14,000	9,569
– Up front shares	2,009	–	1,114	–
– Deferred cash	557	–	3,547	945
– Deferred shares:				
– Restricted shares	14,145	2,812	5,038	2,701
– Performance shares	8,310	528	11,964	1,118
Total	71,694	17,674	57,263	24,473
Number of staff at 31 December	12	10	7	4

Unaudited supplementary financial information (continued)**Disclosure on Remuneration for CG-5 Guideline on a Sound Remuneration System issued by the HKMA (continued)****Analysis of deferred remuneration (note 2)**

	2014		2013	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
At 1 January	49,928	6,620	38,267	16,371
Awarded during the year	23,012	3,340	20,549	4,764
Paid out during the year	(5,356)	(3,037)	(11,077)	(6,355)
Not vested due to performance adjustment	(4,999)	(170)	–	–
At 31 December	<u>62,585</u>	<u>6,753</u>	<u>47,739</u>	<u>14,780</u>
Vested during the year	<u>12,082</u>	<u>2,205</u>	<u>10,484</u>	<u>7,418</u>

Analysis of total amount of outstanding deferred remuneration

	2014		2013	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
At 31 December				
– Vested	9,493	325	452	1,063
– Not-vested	53,092	6,428	47,287	13,717
	<u>62,585</u>	<u>6,753</u>	<u>47,739</u>	<u>14,780</u>
At 31 December				
– Cash	1,494	189	5,858	1,323
– Shares	61,091	6,564	41,881	13,457
	<u>62,585</u>	<u>6,753</u>	<u>47,739</u>	<u>14,780</u>
Total amount of outstanding deferred remuneration exposed to ex post explicit and/or implicit adjustments (note 3)	<u>62,585</u>	<u>6,753</u>	<u>47,739</u>	<u>14,780</u>

Unaudited supplementary financial information (continued)**Disclosure on Remuneration for CG-5 Guideline on a Sound Remuneration System issued by the HKMA (continued)****Analysis of adjustments of deferred remuneration**

	2014		2013	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
Total amount of adjustments during the financial year due to				
– ex post explicit adjustments	(4,999)	(170)	–	–
– ex post implicit adjustments	(16,620)	(1,902)	(5,352)	(1,756)

Analysis of sign-on payments and severance payments awarded during the year

	2014		2013	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
Sign-on payments (including guaranteed performance awards)	2,792	–	–	–
Severance payments	–	–	–	–

Note 1: As defined in the CG-5 Guideline on a Sound Remuneration System issued by the HKMA, senior management are those who are responsible for oversight of either the Bank's company-wide strategy or activities or those of the Bank's material business lines. Key Personnel are individual employees whose duties or activities in the course of their employment involve the assumption of material risk or the taking on of material exposures on behalf of the Bank.

Note 2: The population of Senior Management and Key Personnel in 2014 differs from that of 2013.

Note 3: Ex post adjustments are adjustments made after the awards are granted.